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VOLUME 70 AUGUST, 1953 NUMBER 8

The Legal Maze Created By Forgeries of Checks 421

Provision in Stop Payment Order Limiting Bank's Liability Upheld 444

Constitutionality of Illinois Currency Exchange Act Upheld .. 446

Bankers Liable on Letter of Loan Commitment 452

No Interest Owed on Bank Stockholders' Statutory Liability 464

TRUST DECISIONS 471

TAX DECISIONS 474

For complete table of contents see page ii

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Loans and Discounts		2,276,555,200
Real Estate Loans and Securities		368,251
Customers' Liability for Acceptances		17,270,391
Stock in Federal Reserve Bank		9,600,000
Ownership of International Banking Corporation		7,000,000
Bank Premises		31,290,191
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Capital (*7,200,000 Shares—$20 Par*)	$150,000,000	
Surplus	170,000,000	
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THE BANKING LAW JOURNAL

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VOLUME 70 AUGUST, 1953 NUMBER 8

The Legal Maze Created by Forgeries Of Checks

by JEROME S. TELLER

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One of the most common, but still one of the most difficult problems in the field of bills and notes is that arising in the forgery of the ordinary, every-day check. This note will undertake to discuss the fact patterns and legal consequences which may arise when the forgery is either of the drawer's signature or of an indorsement. Emphasis will be placed upon the Ohio law. At the outset it should be noted that the cases on this subject are numerous, but the problem is not so much one of law as it is channeling the various factual patterns. Therefore, for the purposes of clarity, each fact pattern will be dealt with separately.[1]

DRAWER v. DRAWEE—FORGERY OF INDORSEMENTS OR DRAWER'S SIGNATURE

The most common litigation in the forgery cases is where the drawer seeks recovery from the drawee bank. These cases arise when the drawee has charged the depositor's account with a check bearing a forgery of an indorsement or the drawer's signature and the drawer subsequently attempts to withdraw the funds against which his account has been debited.

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[1] The cases where the drawee bank seeks recovery from the collecting bank are adequately dealt with in 12 CIN. L. REV. 74 (1938), and will not be discussed in this note. There the author notes that the drawee's right to recovery against the collecting bank will depend on whether it was the drawer's signature or some indorsement which has been forged.

Where a drawee bank cashes a check on which the drawer's signature is forged, the note indicates that generally, under the rule of Price v. Neal, 3 Burr. 1354 (1765), the drawee has no recourse against the collecting holder because "a drawee pays or accepts at

It is almost too elementary to state that the drawee bank has no right to debit the account of its depositor after payment of a check bearing either the forged signature of the drawer[2] or a forged indorsement.[3] The reason for this rule is basically simple. Where the check bears the drawer's forged signature there is no order in existence. In the forged indorsement case, while there is a valid order, there has been no compliance by payment to the true payee and the drawee in either instance is not authorized under its contract with the depositor to pay out the latter's money on such an instrument. The contract between the drawer and the drawee imposes a duty on the latter to pay out money for and on behalf of the depositor only on checks issued by him, and the drawee may make payment only to the payee named therein, or his order.[4]

If the drawee does charge the drawer's account with a check on which the latter's signature is forged, then, in the absence of other circumstances, the drawer can recover such amount in an action against the drawee,[5] for the drawee is held to know the signature of the drawer regardless of how skillful the

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his peril a bill on which the drawer's signature has been forged." The doctrine is the settled rule of Ohio. Ellis v. Insurance Co., 4 Ohio St. 628 (1855); First National Bank of Belmont v. First National Bank of Barnsville, 58 Ohio St. 207, 50 N. E. 723 (1899). It has also been adopted by statute. OHIO GEN. CODE § 8167; NEGOTIABLE INSTRUMENTS LAW § 62. The rule of Price v. Neal is not without exceptions and the drawee will be allowed to recover from the collecting holder if the latter was negligent or guilty of bad faith in taking the instrument.

However, where the drawee has paid a check on which an indorsement is forged, the rule is different and the drawee may recover from the collecting holder. Recovery is allowed under the general doctrine that money paid out under a mutual mistake of fact is recoverable. The rule was early adopted in Ohio, Lamson v. Pfaff, 12 Ohio Dec. Rep. 231 (1855).

[2] Ellis v. Insurance Co., *supra* note 1; First National Bank of Belmont v. First National Bank of Barnsville, *supra* note 1. The latter case stated: "The general rule (is) that the drawee of a check, draft, or bill of exchange is held to know the signature of the drawer, and makes payment at his own peril. . . ."

[3] Dodge v. National Exchange Bank, 20 Ohio St. 234 (1870); Dodge v. National Exchange Bank, 30 Ohio St. 1 (1877); Armstrong v. National Bank, 46 Ohio St. 512, 22 N. E. 866 (1889). In the third syllabus of the latter case it was held: ". . . the duty of a bank is in all cases, to pay to the person named, or his order, where the terms of the check are such; and he may, and should withhold payment until fully satisfied as to the genuineness of the indorsement."

[4] This statement is qualified by the exception that arises in the fictitious payee cases. OHIO GEN. CODE § 8114(3), NEGOTIABLE INSTRUMENTS LAW § 9(3), provides: "The instrument is payable to bearer when it is payable to the order of a fictitious or nonexisting person, and such fact was known to the person making it so payable." If the drawer knowingly and intentionally draws a check to a fictitious payee, then, regardless of whether or not there is such a person in actual existence, the check is treated as a bearer instrument passing by delivery alone and the forgery problem does not arise. See 5 CIN. L. REV. 212 (1931) for a general discussion of this problem.

[5] Denbigh v. First National Bank of Seattle, 102 Wash. 546, 174 Pac. 475 (1918).

forgery may have been.[6] Where it is an indorsement that has been forged, the drawer may likewise recover from the drawee who has wrongfully debited his account.[7] The liability of the drawee is not based on negligence, but on the theory that the drawee failed to pay to the payee or subsequent holder as directed by the drawer.

Nevertheless, situations may, and frequently do, arise where, as a result of the depositor's conduct, the drawee will be allowed to debit the drawer's account with all or some of these forged instruments, depending on the circumstances of the particular case. The drawer's negligence may operate to defeat his recovery, or his conduct might be such as to work an estoppel.[8]

A. Drawer's Negligence

The drawer's negligence which will operate to defeat all or part of his recovery will generally arise in one of four situations: (1) where the drawer fails to examine his bank statement and thereby does not learn of the forgery; (2) where the drawer, after learning of the forgery, fails to notify the drawee bank of that fact; (3) where the depositor knowingly retains a dishonest employee; and (4) where the drawer negligently allows the check to get into the forger's possession. Although these are the only situations to be hereinafter discussed, it is conceivable that other actions on the drawer's part might well constitute negligence.

1. Duty to examine bank statement—The drawer's duty to examine his bank statement is well-established. As between the depositor and the drawee bank, the parties standing in the

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[6] First National Bank of Belmont v. First National Bank of Barnesville, *supra* note 1.

[7] Schenke v. Central Trust Co., 58 Ohio App. 441, 16 N. E. 700 (1938). In Armstrong v. National Bank, *supra* note 3, it was held that where, by the fraud of a third person, a depositor of a bank is induced to draw his check payable to a non-existing person, the drawer being in ignorance of the fact and intending no fraud, the drawee bank is not authorized to pay it and charge the amount to the account of its depositor, on the indorsement of the party presenting it, although it appears to have been previously indorsed by the party named as payee. Such indorsement is, in effect, a forgery, and the payments thereon by the bank confer no right on it as against the drawer.

[8] Ohio Gen. Code § 8128, Negotiable Instruments Law § 23, provides: "When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative. No right to retain the instrument, give a discharge therefor, or to enforce its payment against any party thereto, can be acquired through or under such signature, *unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority.*" (Italics added).

relation of debtor and creditor, it is the usual practice for the drawee to render a periodic statement to the depositor which informs him of the status of his account as of a certain day. This statement will list the series of credits and debits for the period covered and will state the current balance. Along with this, the drawee will remit the drawer's cancelled checks for the same period. If the drawer's check stubs have been properly kept, he will have in his possession the means of comparing all the cancelled checks with his own stubs and the bank's check list. Thus, the drawer has the means of ascertaining whether any of the cancelled checks bear his forged or unauthorized signature. The situation is not exactly the same with respect to forged indorsements, for it well may be impossible for the drawer to uncover such forgeries by comparing the bank's statement with his own records. The drawer obviously knows his own signature and the checks he has authorized, but he cannot be expected to be familiar with the handwriting of the various parties who have had title prior to payment. For this reason it is generally held that the depositor is under a duty to the bank to examine its statement, compare it with his records and report any errors within a reasonable time to the drawee bank,[9] but this duty does not extend to an examination of the records in order to determine the validity of indorsements.[10]

The decision in *White Castle v. Huntington National Bank*[11] indicates that Ohio is in accord with this general rule, for that case holds:

"Where it is a custom for a bank, known to its customers, to send out statements at certain intervals, it is the duty of the customer to examine such statements and reconcile them with their own books, and if there is a variance the error must be reported to the bank within a reasonable time."

In that case the drawer maintained two accounts in the same bank where the drawer's agent had his personal account. The

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[9] Scanlon-Gipson Co. v. Germania Bank, 90 Minn. 478, 97 N. W. 380 (1903); First National Bank of Richmond v. Richmond Electric Co., 106 Va. 347, 56 S. E. 152 (1907).

[10] National Surety Co. v. President & Directors of Manhattan Co., 252 N. Y. 247, 169 N. E. 372 (1929); Sprague v. West Hudson County Trust Co., 92 N. J. Eq. 639, 114 Atl. 344 (1921).

[11] 36 Ohio L. Abs. 253, 43 N. E. 2d 737 (Ohio App. 1941); See also Portsmouth Clay Products v. National Bank of Portsmouth, 78 Ohio App. 271, 69 N. E. 2d 653 (1946).

drawer drew a check on its general account payable to its special account and indorsed it for deposit only. Through an oversight the drawer's agent was able to deposit this check in his personal account. However, the failure to make this deposit in the special account could have been ascertained by an examination of the bank statements which the drawee periodically mailed to its depositor. More than two years elapsed before the drawee was notified of this error. Had the drawee been notified within a reasonable time, it could have debited the agent's personal account and credited the drawer. However, within the two years the agent withdrew all the funds from his personal account and at the time notice was given it was impossible for the drawee to recover from him. The court held that the drawer's negligence in not examining its bank statement and immediately reporting the error had caused a loss for the drawee and for this reason the drawer was denied recovery.[12]

2. *Duty to notify bank after knowledge of forgery*—While the drawer is under a duty to examine his bank statements for forgeries of his signature, but not for forged indorsements, the rule is otherwise when the drawer has actual notice of the forgery. In such case, the depositor is under a duty to report this fact to the drawee bank regardless of the nature of the forgery. Thus, in *National Surety Co. v. Manhattan Co.*,[13] it was held that although the drawer was not negligent in failing to examine its cancelled checks for forged indorsements, it was negligent when, after ascertaining the forgeries, it failed to notify the drawee bank. The discovery was made in January, 1924, but the forgeries were not reported to the bank until October, 1924. Although the defense of estoppel was not available since all the forged checks had been presented and paid before the forgeries were discovered, the drawee sought to establish the defense of negligence to offset the depositor's recovery. The latter was admittedly negligent in failing to notify the bank after learning of the forgery, but it did not

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12 An important question raised in this case was whether the bank was guilty of contributory negligence in failing to credit the check to the proper account. The court concluded that "A bank is primarily liable and continuously liable for its errors until such time as the depositor has the opportunity in the exercise of sound business methods to detect the errors and report it." White Castle System v. Huntington National Bank, 36 Ohio L. Abs. 253, 264, 43 N. E. 2d 737, 745 (Ohio App. 1941).

13 *Supra* note 10.

follow from this fact alone that the bank had established a cause of action against the depositor. On the contrary, the bank can have relief only to the extent that it has been damaged by the drawer's negligence. Here, the evidence showed that the drawee could not have procured restitution from the forger even if it had had prompt notice and having suffered no damage from the depositor's neglect, the drawee bank failed to establish a cause of action to offset the drawer's right of recovery.

3. Knowingly retaining a dishonest employee—Where the depositor has knowingly retained a dishonest employee who thereafter causes the loss complained of, this may operate to defeat all or a part of his recovery from the drawee. This may be shown to offset recovery sought on checks bearing either forged indorsements or forgeries of the drawer's name.

In *Hillside Dairy v. Cleveland Trust*,[14] the drawer's bookkeeper over a three and one-half year period drew 102 checks to various payees and cashed them after forging the indorsements. The checks were all paid by the drawee and charged to the drawer's account. The record showed that about a year after the bookkeeper was employed by the drawer, it was discovered that he had had financial difficulty with his previous employer and had made a settlement for a shortage in cash, after which he left that company. The court, recognizing that a depositor's negligence may constitute a defense in an action against a depository,[15] held that the drawer could not recover when, as here, the loss was due to his negligence in knowingly retaining an employee who, having previously been guilty of defalcations, caused the loss for which recovery is now sought. The court relied on the familiar rule that "where one of two innocent parties must suffer because of a fraud or forgery, justice imposes the burden on him who is first at fault and put in operation the power which resulted in the fraud or forgery."[16]

As is often the case, the same fraudulent employee who has either forged the drawer's name or the payee's indorsement is the one who is entrusted with the duty of examining the state-

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[14] 142 Ohio St. 507, 53 N. E. 2d 499 (1944).

[15] Jones v. People's Bank, 95 Ohio St. 253, 116 N. E. 34 (1917).

[16] Weisberger v. Barberton Savings Bank, 84 Ohio St. 21, 95 N. E. 379 (1911).

ment rendered by the drawee bank. Obviously, it will be to his self interest to withhold knowledge of the fraud. The courts have not failed to take cognizance of this fact and generally hold that although the principal is not chargeable with knowledge of his agent's dishonest act adverse to the principal's interest, he is nevertheless chargeable with knowldge of such facts as an honest agent would acquire in performing his duty in examining the bank statements.[17] In *Portsmouth Clay Products v. National Bank of Portsmouth,*[18] the Ohio court held:

"The fact that a depositor has entrusted performance of its duty to examine statements rendered to it by the bank and to give notice of errors therein, to a dishonest employee who has diverted the depositor's check to his own account does not excuse the depositor's failure to notify the bank of errors, since the depositor was chargeable with knowledge which an examination by an honest employee would have disclosed."[19]

It was clearly shown that the bank statements furnished the drawer could not have been reconciled with its books by an honest employee. In accordance with this finding and the general rule, it was held that the drawer's failure to report any variance or discrepancy between its books and the periodic statements furnished by the bank precluded any recovery by the depositor against the bank.

4. Drawer causes check to get into forger's possession— Special note should be taken of the case of *Weisberger v. Barberton Savings Bank*[20] which is a leading case in this field. This factual situation showing negligence by the drawer may arise where recovery is sought on a check bearing a forged indorsement. There the drawer owed money to Max Roth in New York, but by mistake he mailed the check to Max Roth in Cleveland. The check was delivered to a person with that name in Cleveland and he in turn indorsed and cashed the instrument.

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17 Erickson v. Iowa National Bank, 211 Iowa 495, 230 N. W. 342 (1930).
18 *Supra* note 11.
19 White Castle System v. Huntington National Bank, *supra* note 11.
20 *Supra* note 16.

The drawee charged the drawer's account. Since the indorsement was not by the person intended as payee, it was, in effect, a forgery. Although the drawer notified the drawee as soon as it learned of this fact, recovery was denied, the court holding that the drawer was the party at fault and its negligence contributed directly to the wrongful and fraudulent appropriation.

B. Proximate Cause and Contributory Negligence.

Needless to say, not all negligence on the part of the drawer will preclude his recovery from the drawee. In *Provident Savings Bank* v. *Western Life Insurance*,[21] the drawer was admittedly negligent. However, it was stipulated in the record that the drawee had relied entirely on the guaranty of the indorsing bank. For this reason the court held that the drawer's negligence was no defense as it was not the proximate cause of the bank's loss.

Even where there is no question but that the drawer was negligent, this is not dispositive of the case, for there is still the question of whether the bank was or was not guilty of contributory negligence. As has already been stated, the depositor owes a duty to the drawee bank to examine his bank statement and within a reasonable time to report forgeries of his name to the drawee bank. If he fails to do this, he is precluded from recovering against the drawee bank to the extent that this inaction has caused loss to the latter. However, it is pointed out in *Glassell* v. *Citizens' National Bank*:[22]

"This rule assumes that the bank itself has not been guilty of negligence in making the payment, for when by the exercise of proper care it could have discovered the alteration or forgery, it must bear the loss notwithstanding that the depositor failed in his duty to examine the accounts."

Thus, in *Basch* v. *Bank of America*,[23] the drawer was clearly negligent in failing to examine his bank statements, but he was still allowed to recover for a series of checks bearing forgeries

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[21] 41 Ohio App. 261, 179 N. E. 815 (1931).
[22] 191 Cal. 375, 216 Pac. 1012 (1923).
[23] 22 Cal. 2d 205, 139 P. 2d 1 (1943).

of his signature as the evidence showed that the drawee was guilty of contributory negligence for it could and should have discovered the forgeries. Stating the rule in terms of negligence, the court held that a bank which is guilty of negligence in failing to discover a forgery cannot avoid liability on the ground that the depositor was negligent in failing to examine his balanced passbook, statement of account, or returned checks.[24]

C. Estoppel

Apart from the question of the drawer's negligence, still another defense which might be raised by the drawee bank is that the depositor by his conduct has estopped himself from setting up the forgery.[25] Although the defenses of negligence and estoppel are somewhat intermingled, there is a vast distinction between the two. It may best be shown by example. Thus, suppose *A's* employee *B* forges *A's* name to four checks each month for a period extending from January to December. Each check is for $100. The drawee renders periodic bank statements to the depositor, but he either fails to examine them or does not notify the bank after learning of the forgeries. Later the depositor sues the bank for having wrongfully charged its account with checks amounting to $4,800, the aggregate of the forged instruments. The checks paid and returned with the first monthly statement received by the depositor after the forgeries began will be treated differently from the checks similarly and subsequently forged.

As to the first four checks initially forged and returned to the drawer in the January bank statement, the drawee may seek to establish the drawer's negligence in his having failed to examine its statement and report the forgery to the bank. For this to be the case, the bank must show to what extent it has been damaged by the drawer's negligence. If the drawee shows that it would have had complete restitution from the forger in the event of prompt notice by the drawer, it can set-

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[24] 7 Am. Jur. § 516, 371.

[25] Arant, Forged Checks—The Duty of the Depositor to His Bank, 31 Yale L. J. 598 (1921-22).

off this entire amount ($400) from the drawer's recovery. But, under the negligence theory, if the evidence shows that the drawee would have had only partial or no restitution at all from the forger had there been prompt notice, the bank is only allowed to set-off this limited amount of damage which it has actually suffered from the drawer's negligence.

Will the estoppel rule afford the drawee any defense as against the initial four forgeries which were returned in the January bank statement? It should be noted that under the negligence theory, the drawer is not precluded from establishing a cause of action, but the drawee bank is merely allowed to set-off the damage it has suffered as a result of the negligence. Under the estoppel theory, the drawee's defense is that the drawer by his words or conduct has represented that the checks are good and the bank, relying on this representation, has paid money over to the forger. Since the bank has relied on the depositor's representation to its detriment, the drawer is said to be estopped from setting up the forgery. Although the negligence theory may provide the drawee with some defense as against the first four checks, depending on the amount of damage it suffered as a result of the depositor's negligence, the estoppel rule affords the drawee no defense as to the initial forgeries. In order to establish an estoppel there must be a representation and a reliance thereon. The only representation that can be established on the drawer's part must be implied from the fact that it did not notify the drawee bank of the forgery after it did or should have had notice thereof. The drawer's silence is an implied representation that the checks were valid. Although a representation can be shown, no reliance thereon and resulting detriment can be established. This is simply because the drawee had paid the first four checks before it had sent the drawer the bank statement and, therefore, before the latter can be said to have made a representation as to the genuineness of the instruments. Thus, as to the initial forgeries returned in the first bank statement, the estoppel rule does not apply, and as to these checks the drawee's only defense is one of set-off for the damage it suffered from the drawer's negligence.[25a]

[25a] *Supra* note 13.

With respect to the checks forged after January, the outcome is different. These checks were paid by the bank after it had rendered the January statement, and after the drawer had or should have had notice of the initial four forgeries. As to the checks forged between February and December, the drawee may set up either the defense of negligence or estoppel, the latter generally being the most favorable. If the depositor negligently failed to examine not only the first, but all of the bank statements, its recovery may be completely defeated by an application of the negligence rule provided the drawee can show that it could have had complete restitution from the forger had it been promptly notified and further that nothing was recoverable from the forger when notice finally was given. The same result is had under the estoppel rule as to all the checks except the initial four, it having already been pointed out that as to them the estoppel rule does not apply and the drawee's only defense is on negligence. But with respect to the subsequent forgeries, the drawer is estopped from setting up this fact. When the depositor failed to notify the bank of the forgeries after it had or should have had notice of the fraud from the January statements, its silence was looked upon by the bank as a representation that the checks were valid. Thereafter, the bank relied on this representation and paid the forged instruments drawn in the following months. Thus, there was a representation and a reliance resulting in detriment to the drawee if the forger is now without assets, and the drawer will now be estopped from setting up the forgery.

The distinction between the two defenses will become important when the drawee bank at the time of receiving actual notice could recover partial, but not complete, restitution from the forger. The checks drawn between February and December amounted to $4,400, but suppose that at the time actual notice of the forgeries was given to the bank it could only recover $2,000 from the forger. Under the negligence theory, the drawer could recover $2,400 from the bank as the latter could only set-off $2,000, that being the amount it has been damaged as a result of the drawer's negligence. In this case it is for the bank to proceed against the forger for the additional $2,400 it

has lost. However, under the estoppel defense, the outcome is otherwise. There having been a representation by the depositor and a reliance by the bank, the former is completely precluded from recovering from the drawee. This is true even though the detriment to the bank was only $2,400. Under the estoppel rule the detriment suffered by the drawee need not be to the full extent of the $4,400, but it is enough that there has been some detriment. In such case it is for the drawer rather than the drawee to proceed against the forger to recover whatever amount he still possesses.

Ohio has expressly recognized this estoppel rule. In *Fourth & Central Trust* v. *Johnson*,[26] it was stated:

"The rule is that the burden of justifying payment of a check or draft is on the bank, and, if money is paid on a forged check, the sole defense under the Ohio rule would be to show action or conduct on the part of the drawer creating an estoppel."[27]

Thus, one may by conduct, statements or silence estop himself from claiming that his signature is a forgery, but before he can be estopped by mere silence, facts must be alleged and proved showing a duty and opportunity to speak, that he knew or had reason to believe that the holder of the forged instrument would rely on his silence, and that the holder did in fact rely on his silence and was in fact injured thereby.[28] The point is best illustrated by *Graef* v. *Dime Savings Bank*.[29] There, when the drawer learned that several of his checks has been forged by a relative, he told the drawee bank he wanted his account to stand the loss. Since he did not want the forger prosecuted, he promised to forego the credits offered him by the bank. The court held that this action was sufficient to estop the drawer from latter claiming the amount of the checks from the drawee.

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[26] 24 Ohio App. 129, 156 N. E. 462 (1927); See also Schenke v. Central Trust, *supra* note 7.

[27] Although this quotation seems to indicate that estoppel is the only defense in Ohio, it has been shown in the cases preceding that the drawer's negligence may also defeat his recovery.

[28] Shinew v. First National Bank, 84 Ohio St. 297, 95 N. E. 881 (1911).

[29] 24 Ohio L. Abs. 409 (Ohio App. 1937).

D. Ohio Statute of Limitations

In discussing the rights of the drawer as against the drawee, it is significant to note that to some extent this situation is regulated by statute in Ohio. Ohio General Code § 11225-1 provides:

"No bank which has paid and charged to the account of a depositor any money on a forged or raised check issued in the name of said depositor shall be liable to said depositor for the amount paid thereon unless either, (1) within one year after actual written notice to said depositor that the vouchers representing payments charged to the account of said depositor for the period during which such payment was made are ready for delivery, or (2) in case no such notice has been given, within one year after the return to said depositor of the voucher representing such payment, said depositor shall notify the bank that the check so paid is forged or raised."

Thus, the drawer's action will be barred without regard to the question of negligence unless, within one year after receiving the bank statement or a notification that it is ready for delivery, he notifies the drawee of the forgery.[30]

In *Lincoln National Bank* v. *Morgan*,[31] the drawee bank sought to raise the statute of limitations provided for in § 11225-1. In that case no notice was ever given to the depositor, nor were any checks ever returned to her. On the contrary, the cancelled checks had been returned to the forger. The court held that to avail itself of the privileges of the statute, the bank must bring itself strictly within its provisions and when the cancelled checks to which the depositor's signature had been forged were returned to the forger and no notice was given to the depositor, the statutory limitation did not apply to the depositor's action against the bank.

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[30] See American Surety Co. v. Cortland Savings & Banking Co., 143 Ohio St. 353, 55 N. E. 2d 583 (1944), where the drawee bank had not received notice of the forgery within one year after having mailed the statement to the drawer and the drawer's action was barred under the statute.

[31] 46 Ohio App. 9, 187 N. E. 646 (1933).

Provident Savings Bank v. *Fifth-Third Union Trust*,[32] held that this one year statute did not apply to checks bearing forged indorsements. Nevertheless, this case is no longer of importance for the legislature has since adopted § 11225-2 which is to the same effect as 11225-1 except that the former section applies to forged indorsements and gives the drawer two years, rather than one, within which to notify the drawee of the forgery.

Drawer v. Collecting Holder—Indorsement Forged

When it is an indorsement that is forged and the drawer is the one seeking recovery, he will usually proceed against the drawee bank as his right of recovery from the drawee is generally recognized. However, cases have arisen where the drawer attempts to maintain an action against the collecting holder who has received payment from the drawee on the instrument bearing the forged indorsement.[33] The leading case in Ohio and the one most often quoted on this problem is *Lavanier* v. *Cosmopolitan Bank*.[34] In that case the court held that since the drawee bank's payment on a check bearing a forged indorsement was a nullity, the drawer's right to his deposit remained unaffected. Therefore, the court concluded that the drawer could not recover against the intermediate cashing bank, because the drawer's money was still in the drawee bank.

The recent case of *Butler Produce* v. *Edgerton State Bank*[35] does not deal directly with this point, but, in dictum, the court took issue with the *Lavanier* case. The Ohio court[36] in the *Butler* case seems to state that in the interest of avoiding

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[32] 43 Ohio App. 533, 183 N. E. 885 (1932).

[33] It is conceivable that the drawer might seek recovery from the collecting bank when there has been payment on a check bearing a forgery of the drawer's signature. In fact, this might be his only recourse if his action against the drawee bank was barred by § 11225-1. However, it is unlikely that the drawer would recover. Since the drawee cannot properly charge the drawer's account with such a check, the drawer's money is still in the drawee bank, and, having sustained no loss, he should not be allowed to recover from the collecting bank. Furthermore, the action cannot be maintained on the theory that it prevents a multiplicity of suits. Although the drawer may recover from the drawee, the drawee cannot, because of the Price v. Neal doctrine, recover from the collecting bank. Thus, the drawer cannot say that he is standing in the drawee's shoes.

[34] 36 Ohio App. 285, 173 N. E. 216 (1929).

[35] 91 Ohio App. 385 (1952).

[36] The *Lavanier* case was decided by the Court of Appeals for Hamilton County; the *Butler* case was decided by the Court of Appeals for Williams County.

a multiplicity of suits, the drawer should be allowed to maintain the action against the collecting bank. Nevertheless, the *Lavanier* case still represents the weight of authority.[37] Britton in his works on bills and notes[38] points out that the drawer may be able to maintain the action if he takes an assignment from the drawee of its cause of action against the collecting bank. He further notes that an assignment by operation of law is "questionable" where the drawee is solvent, and, in all events, when the drawee is insolvent there cannot even be an express assignment to the drawer as this would give the drawer a preference as against other unsecured creditors of the drawee.

Payee v. Drawee—Indorsement Forged

Where the payee's indorsement on the check is forged and the drawee bank had paid the party in possession of the instrument, the payee may seek recovery from the drawee. Various theories have been set forth to handle this situation, but the law applicable to many of these is still relatively unsettled. Ohio General Code § 8294 deals directly with the rights of a holder against the drawee bank and provides:

"A check does not of itself operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder unless and until it accepts or certifies the check."[39]

By virtue of this section it is necessarily implied that the holder is allowed successfully to maintain an action against the drawee bank who has paid under a forged indorsement when the latter has either accepted or certified the check.[40]

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[37] First National Bank of Bloomingdale v. North Jersey Trust Co., 18 N. J. Misc. 449, 14 A. 2d 765 (1940); General Fire Assurance Co. of Paris v. State Bank, 177 App. Div. 745, 164 N. Y. Supp. 871 (1917).

[38] Britton, Bills & Notes 679, § 144 (1943).

[39] Negotiable Instruments Law § 189. Note also Negotiable Instruments Law § 127 which has almost identical wording except that it applies to bills of exchange. However, it should be noted that § 189 provides there is "no liability to the holder" while § 127 states there is no liability "on the bill."

[40] If, in addition to the mere drawing and delivery of the check, there were additional evidence of an assignment, the holder might be allowed to maintain this action as an assignee. The statute makes it clear that the check in and of itself does not operate as an assignment of any part of the drawer's funds. It should be noted that if the instrument is so drawn as to amount to an assignment, it would no longer be negotiable, for one of the qualities of negotiability is that the instrument must be payable generally and not out of a particular fund.

The majority of cases arising under the statute raise the question of whether the payee may sue the drawee who has *paid* a check bearing a forged indorsement, but has not formally accepted the instrument. This necessarily raises the question of what constitutes acceptance,[41] and, more specifically, whether payment alone is an acceptance. It is well-settled, not only in Ohio,[42] but by the weight of authority,[43] that payment of a check bearing a forged indorsement does not operate as an acceptance of the check so as to authorize an action by the real owner to recover its amount from the drawee bank.

In *Elyria Savings & Banking* v. *Walker Bin Co.*,[44] the drawee paid a check on which there was a forged indorsement to the party in possession thereof and then stamped its name on the check and also the word "paid." The payee, whose indorsement had been forged, brought an action against the drawee bank seeking to recover the amount of the check and contended that when the drawee stamped its name and the word "paid" on the instrument and charged the same to the account of the drawer, there was an acceptance and the banking company thereby became liable to the rightful owner. The Ohio court held that the payee can recover only when he brings himself within the provision of § 8294. It was further noted that Ohio General Code § 8237 provides that an acceptance must be in writing and must be signed by the drawee.[45] The mere stamping of the word "paid" on the check did not amount to an acceptance. Thus, the court concluded that since the plaintiff had not brought himself within the purview of § 8294, the trial court was correct in directing a verdict against him.

The *Walker Bin* case was quoted and approved by the Ohio Court of Appeals in *Allen* v. *Home Savings Bank*.[46] There

[41] Ohio Gen. Code § 8242, Negotiable Instruments Law § 137 providing for constructive acceptance is not applicable here.

[42] Elyria Savings & Banking Co. v. Walker Bin Co., 92 Ohio St. 406, 111 N. E. 147 (1915); Allen v. Home Savings Bank Co., 33 Ohio App. 133, 168 N. E. 399 (1929).

[43] B. & O. R. R. v. First National Bank, 102 Va. 753, 47 S. E. 837 (1904); Whorf v. Seattle National Bank, 173 Wash. 629, 24 P 2d 120 (1933); Southern Trust Co. v. American Bank, 148 Ark. 283, 229 S. W. 1026 (1921); Lone Star Trucking Co. v. City National Bank, 240 S. W. 1000 (Tex. Civ. App. 1922); National Union Bank v. Miller Rubber Co., 148 Md. 449, 129 Atl. 688 (1925).

[44] *Supra* note 42.

[45] Negotiable Instruments Law § 132.

[46] *Supra* note 42.

the payee's petition alleged that the drawee bank had paid a check to a party who had forged the payee's indorsement on the instrument. The drawee's demurrer was sustained as the petition did not allege that the bank had certified or accepted the check as required by § 8294.

If the drawee who pays a check bearing a forged indorsement is not liable to the holder in the absence of formal acceptance, the next question is whether the drawee may be held liable on some other theory.

It is clear that the holder may not manitain an action for money had and received. The drawee cannot lawfully debit the drawer's account. It has not received money from the drawer with which to pay the instrument, but, instead, the drawee has paid out its own money.[47] It has been said that the holder might maintain the action as the beneficiary of a third party beneficiary contract, but this theory, at best, is doubtful.[48]

The majority of cases allowing recovery for the holder on a theory outside the field of bills and notes hold that the drawee is an innocent converter and is liable for having undertaken to exercise ownership without authority over a check which belonged to the holder. The courts which allow the conversion theory generally state that the holder is not suing for breach of contract in not paying the check. Instead, their argument is that when the drawee bank pays the check and then undertakes to return it to the drawer, it is exercising dominion and control over the property of the holder and such interference with the latter's property constitutes a conversion.[49] The decisions are not in accord on this point and there are cases which have expressly denied recovery on this theory.[50]

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[47] BRITTON, BILLS & NOTES 685 § 146 (1943).

[48] See 7 CIN. L. REV. 305, 312 (1933) for a discussion of this approach.

[49] Louisville & N. R. R. v. Citizens' & Peoples' National Bank of Pensacola, 74 Fla. 385, 77 So. 104 (1917); Lewis State Bank v. Raker, 138 Fla. 227, 189 So. 227 (1939); Moler v. State Bank of Bigelow, 176 Minn. 449, 223 N. W. 780 (1929); Annett v. Chase National Bank, 196 App. Div. 632, 188 N. Y. Supp. 7 (1921).

[50] Gordon Fireworks v. Capital National Bank, 236 Mich. 271, 210 N. W. 263 (1926); Lone Star Trucking Co. v. National Bank of Commerce, *supra* note 43.

See 7 CIN. L. REV. 305, 308 (1933) where the writer states that the drawee cannot be held as a converter because ". . . a failure to return the check to the true owner cannot constitute an acceptance, for an acceptance, to bind the acceptor, must be in writing, and in the absence of any demand or request for a return, it is clear that a mere failure to return does not bind the drawee as acceptor." The difficulty with this analysis is that

The Supreme Court of Ohio in the *Walker Bin* case held that § 8294 was intended to cover the liability of a bank to the holder of a check and the latter can recover from the bank only when he brings himself within the provisions of this statute. The court made its position clear by the following language:

"We are of the opinion that when the legislature enacted § 8294 it intended to cover the subject of the liability of a bank to the holder of a check. It prescribed when and only when there is liability to the holder. In the absence of the conditions therein prescribed no right of action exists in favor of the holder."[51]

This is strong language and clearly indicates that the holder must bring himself within the purview of the statute and that the Ohio court will not entertain any other action whether it be in tort or otherwise.[52]

Payee v. Collecting Bank—Indorsement Forged

If, as the Ohio court strongly intimates, the payee whose indorsement has been forged has no cause of action against the drawee bank "unless and until it accepts or certifies the check,"[53] then if the payee is to have recovery, he must seek it elsewhere. It is possible that the payee may sue the drawer of the check, not as a drawer, but as a debtor on the account for which the check was originally given. Nevertheless, the payee may not always be successful.[54] In the *Walker Bin* case,[55] the payee's action against the drawer for goods sold was defeated when the court found that the drawer had delivered the check to the payee's agent (forger). Since the agent had authority to receive the check, delivery thereof cancelled the drawer's obligation to the amount of the check. Therefore, if the payee is to get recovery, assuming the forger has absconded or is "judgment

when the holder seeks to hold the drawee as an acceptor, the action is *ex contractu*, while when the suit is for conversion, the action is *ex delicto*. Therefore, in the conversion action, whether or not there was an acceptance is immaterial.

[51] *Supra* note 42 at 414.

[52] However, it should be noted that the *Walker Bin* case was an action sounding in contract.

[53] Elyria Savings & Banking Co. v. Walker Bin Co., *supra* note 42.

[54] This would clearly be the case if the check had been given to the payee as a gift.

[55] *Supra* note 42.

proof," he must look to the collecting bank which paid the forger and in turn received money from the drawee bank.

As a general rule, the payee is allowed to recover in an action against the collecting bank which has paid another on an instrument bearing the payee's forged indorsement,[56] and the only difficulty in these cases is the theory upon which recovery is allowed. The cases dealing with this factual situation may be broken down into two groups: (1) those allowing recovery in an action for money had and received, and (2) those allowing the recovery in an action for conversion.

In *Universal Carloading & Distributing Co.* v. *South Side Bank,*[57] the payee's petition alleged that its clerk without authority had indorsed the payee's name on checks payable to the payee and that the defendant bank had cashed them and in turn received payment from the drawee bank. In ruling on the defendant's demurrer, the court held that the petition did not state a cause of action for conversion in that it failed to allege that the plaintiff was in possession, or entitled to possession, of the checks in question. However, the court held that the petition did charge that the defendant had received money belonging to the plaintiff and this was sufficient to support an action for money had and received. The bank was under a duty to ascertain the validity of the indorsement, and when it collected checks with forged indorsements, the money it received upon them from the drawee belonged to the owner of the checks.

In *Crisp* v. *State Bank,*[58] a check on which the payee's signature was forged was presented to the defendant bank who paid the forger and in turn received payment from the drawee bank. The court held that the payee may ratify the delivery to the person who took the check without ratifying the forged indorsement, and may maintain an action of trover

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[56] Brannon's Negotiable Instruments Law 450-454, § 23 (7th ed. 1948); Britton, Bills & Notes § 147 (1943).

[57] 27 S. W. 2d 768 (Mo. App. 1926); See also Welch v. Diehl's Estate, 278 S. W. 1057 (Mo. App. 1926) to the effect that the action is one for money had and received and not one for conversion.

[58] 32 N. D. 263, 155 N. W. 78 (1915).

against the intermediary bank for the conversion of such check.[59]

In Ohio it is generally accepted that the payee may recover from the collecting bank, but here, as in other jurisdictions, the theory of the action is somewhat unsettled. The leading case in Ohio is *Shaffer* v. *McKee*.[60] There the payee was allowed to recover from the collecting bank, the avoidance of a multiplicity of suits being recognized by implication. The theory of the *Shaffer* case seems to be: (1) the payee may recover from the drawer on the original contract for which the check was given; (2) the drawer may recover from the drawee for having wrongfully charged his account; (3) the drawee may recover from the collecting bank since it paid the money under a mutual mistake of fact. Thus, if the payee is allowed to recover directly from the collecting bank, the same result will be reached with one suit which otherwise would necessitate three actions.

In *Central Trust Co.* v. *Backsman*,[61] the Ohio Court of Appeals applied the tort theory in allowing the payee recovery from the collecting bank. The defendant denied liability on its part, but the court held that although there was not liability on the check, the check itself was property, the ownership and possession of which are safeguarded to the same extent as other classes of property. The court concluded that when the defendant took possession of the check, presented it for payment, and received from the drawee the money, it tortiously exercised dominion over the check inconsistent with the ownership of the payee. The defendant had converted the plaintiff's property to its own use and in such case the amount of the damages would be *prima facie* the face amount of the check.

On similar facts, the Ohio Court of Appeals in a recent case, *Butler Produce* v. *Edgerton State Bank*,[62] although granting relief for the payee, disagreed with the theory applied

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[59] See also Wagner Trading Co. v. Battery Park National Bank, 228 N. Y. 37, 126 N. E. 347 (1920) where the conversion theory was also applied.

[60] 19 Ohio St. 526 (1869).

[61] 50 Ohio App. 512, 198 N. E. 730 (1935).

[62] *Supra* note 35 at 391.

in the *Backsman* case and stated: "the more cogent reasoning and authority support the theory that the action is *ex contractu* for money had and received rather than *ex delicto* for conversion." The court relied on Ohio General Code § 8128 which provides:

"When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative. No right to retain the instrument, give a discharge therefor, or to enforce its payment against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority."[63]

The court went on to state that although the statute does not specifically refer to the liability of a collecting bank who collects the proceeds upon a forged check, there is ample authority for holding the bank liable to the payee whose name has been forged as upon an action for money had and received. The bank is said to have assumed the risk in relying on the genuineness of the payee's indorsement.

The main issue in the *Butler* case was whether the payee-plaintiff was "precluded from setting up the forgery or want of authority." The payee's employee had indorsed the former's name without authority, but the defendant bank had contended that the agent had apparent, if not actual, authority to indorse and cash checks and as such, the payee was precluded from setting up lack of authority. In response to this argument, the court held that the doctrine of "two innocent persons" is applicable and the payee whose name had been forged may by his conduct be estopped from asserting the forgery, but when the payee does nothing to clothe the forger with indicia of authority to indorse such checks other than, as was the case here, to permit such check to come into the forger's possession, the "two innocent persons" rule does not apply. For that rule to apply the acts of the payee must in some manner contribute to cause the collecting bank to pay the forged checks.[64].

[63] Negotiable Instruments Law § 23.

[64] See Pyper v. Climer, 29 Ohio App. 486, 162 N. E. 646 (1928), where it was held that a payee who had delivered a check unindorsed to an agent with instructions to deposit it

Probably the better view is that stated by the Supreme Court of Pennsylvania in *Lindsey* v. *First National Bank.*[66] There the court stated that the distinction between forms of actions has lost much of its former importance; and the court looked instead to the substance involved. Speaking further on this point, the court held that the payee of a check may elect among actions in tort for conversion, in assumpsit for money had and received, and in tort with a count for money had and received in suing a collecting bank.

A question sometimes arising in these cases is whether a payee to whom the check had not been delivered could recover from the collecting holder. Britton, approving the decision in *Feitel House Wrecking* v. *Citizens Bank & Trust Co.,*[66] states:

"Where there has been no delivery to the payee and the instrument is stolen from the drawer, the payee's indorsement forged and payment made by the drawee to the party in possession the payee has no right to recover from such party because of the absence of any property right in the payee."[67] This view is criticized by Brannon who holds that the payee should be allowed to maintain the action even though he never had possession of the instrument.[68] This approach, which seems to be the better view, proceeds upon the theory that the payee could sue the drawer on his original claim of debt, the drawer could recover from the drawee and the latter from the collecting bank. Therefore, to allow the payee who has never had possession of the check to maintain the action is to use one suit to reach by a desirable short cut the person who should, in any event, be ultimately liable as among the innocent persons involved in the transaction.[69]

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as security for the rental of an airplane was precluded under OHIO GEN. CODE § 8128 by his acts from setting up the defense of forgery as against a holder for value who had received the check from the agent bearing the payee's forged indorsement.

[65] 190 Atl. 876 (Pa. Super. 1937).

[66] 159 La. 752, 106 So. 292 (1925); See also People *ex rel.* Nelson v. Kaspar American State Bank, 364 Ill. 121, 4 N. E. 2d 14 (1936); Jones v. Bank of America National Trust & Savings Association, 49 Cal. App. 2d 115, 121 P. 2d 94 (1942).

[67] BRITTON, BILLS & NOTES 690, § 147 (1943).

[68] *Supra* note 56 at 453.

[69] See 21 MICH. L. REV. 819 (1922-23) which criticizes Allen v. Mendelsohn, 207 Ala. 527, 93 So. 416 (1922), for having allowed the payee to maintain an action of assumpsit although the check had never reached his hands. *Contra:* 25 COL. L. REV. 226 (1925).

This question was dealt with by the Ohio Supreme Court in *Shaffer* v. *McKee*.[70] There the check was stolen from the mail. The thief forged the payee's name and cashed it with the defendant bank who in turn collected from the drawee. Although the payee never had possession, he was allowed to recover from the collecting bank. The *Backsman* case, in dictum, also indicates that it would allow the payee to maintain the action against the collecting bank even though the payee himself had never had possession of the instrument.[71]

At this point no conclusion need be drawn, for what has been said is self-explanatory. As was stated at the outset, the problem in these cases is not so much one of law, but more so one of fact—that is, the nature of the forgery and the parties involved in the litigation. The note has sought only to state the problems and the treatment thus far given by the courts.

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[70] *Supra* note 60.

[71] *Supra* note 61 at 516.

BANKING DECISIONS

In this department are published each month all of the important decisions of the Federal and State Courts involving questions pertaining to the law of banking and negotiable instruments. The experiences they disclose deserve careful attention and study of bankers, bank counsel, the depositor and the bank student seeking advancement.

Provision in Stop Payment Order Limiting Bank's Liability Upheld

To stop payment on a $1,225 check a depositor signed a Request to Stop Payment on a form provided by his bank. The request contained a provision that if the bank paid the check through "inadvertence, accident or oversight" it was not to be responsible to the depositor. When the bank did pay the check inadvertently and the depositor brought suit the court ruled in favor of the bank and upheld the validity of the inadvertence provision. It was pointed out, however, that the bank would have been liable to its depositor if the request had not contained such a limiting provision. *Thomas v. First National Bank of Scranton,* Superior Court of Pennsylvania, 96 A. 2d 196. The opinion of the court is as follows:

HIRT, J.—This action in assumpsit was tried on stipulated facts. The defendant, a National Bank in the City of Scranton, had accepted the plaintiff as a depositor prior to October 12, 1950 and he then had funds with the bank, in a checking account. On the above date he delivered his check, drawn on the bank, to Sabor Dental Supply House as payee, in the sum of $1,225. On the following day plaintiff went to the bank for the purpose of stopping payment on the check and there signed a "Request to Stop Payment" on a printed form submitted to him by one of defendant's clerks. The request addressed to the bank, which he signed, contained the following: "Should the check be paid through inadvertence, accident or oversight, it is expressly agreed that the bank will in no way be held responsible. The Bank receives this

NOTE—For similar decisions see B. L. J. Digest (Fifth Edition) §1474.

request upon the express condition that it shall not be in any way liable for its act should the check be paid by it in the course of its business. The undersigned agrees to be legally bound hereby." On October 16, three days after the plaintiff signed the stop-payment order, the check was paid by the defendant bank on presentation, "through inadvertence, accident, or oversight" and was charged against the funds on deposit in plaintiff's account. This suit was brought to recover $1,225, when the defendant on demand refused to credit plaintiff's account with the amount of the check on which plaintiff had stopped payment. The case was tried without a jury resulting in a judgment in plaintiff's favor against the defendant for the amount of the check with interest.

It is the rule in this State that an open deposit created by a customer of a bank is subject to his order as the depositor. A check is no more than an order on the bank to pay a stated amount to a named payee from the maker's account and, as such, may be revoked at any time before the check is paid or accepted for payment by the bank. The usual method of revocation is by notice to the bank on which the check is drawn to stop payment and such direction, being the last order of the depositor affecting his account, is binding on the bank. In general, if payment of a check is made by the bank on which it is drawn, after such notice, the bank does so at its peril. Wall v. Franklin Trust Co., 84 Pa. Super. 392; German Nat. Bank v. Farmers' Deposit Nat. Bank, 118 Pa. 294, 12 A. 303. If the plaintiff in this case had directed the bank categorically to stop payment, regardless of the form of the order, Thompson v. Republic Trust Co., 84 Pa. Super. 183, there could be little question as to the bank's obligation to make restitution under its common law liability to the plaintiff.

Plaintiff's stop-payment order however was not absolute but was qualified by the terms of the request which he signed. The common law liability of a bank may be limited provided the limitation has the assent of the depositor. In the instant case the intention of the parties in relation to limiting the bank's liability was clearly expressed in the stop payment direction executed by plaintiff. The rule of freedom of contract therefore will prevail and since under the stipulated facts the check was paid by the bank although "Through inadvertence, accident or oversight" its act was within the limitations of the bank's liability to which plaintiff had assented, and the plaintiff therefore cannot recover. Notwithstanding the conflict of judicial opinion on the subject, a release of liability as in this case is not rendered inoperative on the ground of public policy. Such releases, in common use by banks, relate exclusively to personal and private affairs. One is not obliged to agree to a limitation of the common law obligation of a bank to honor an unequivocal stop-payment order but if he does, his release (apart from

the question of consideration) is enforceable insofar as it contains a clear expression of his intention since no public interest is involved.

The majority of the cases and certainly the weight of authority support the view that a stipulation releasing a bank from liability on paying a check in disregard of a stop-payment request constitutes a valid enforceable contract. Gaita v. Windsor Bank, 251 N.Y. 152, 167 N.E. 203 and Tremont Trust Co. v. Burack, 235 Mass. 398, 126 N.E. 782, 9 A.L.R. 1067, are typical. Cf. Cohen v. State Bank of Philadelphia, 69 Pa.Super. 40 and 175 A.L.R. 79 and 1 A.L.R.2d 1155 where the cases are collected.

The decisions in some of the cases holding that such releases are unenforceable rest upon lack of consideration for the relinquishment of the depositor's absolute common law right to look to the bank for reimbursement. Reinhardt v. Passaic-Clinton Nat. Bank & Trust Co., 16 N.J.Super. 430, 84 A.2d 741, is illustrative of that class of cases. The assertion of lack of consideration however is not available to the present plaintiff in seeking to avoid the limiting terms of his stop-payment request. The release which he signed specifically provides: "The undersigned agrees to be legally bound hereby." Plaintiff's agreement to that effect removes lack of consideration from the case as a ground for avoiding the effect of the release, under the Uniform Written Obligations Act of May 13, 1927, P.L. 985, 33 P.S. § 6.

Judgment reversed and here entered for the defendant.

Constitutionality of Illinois Currency Exchange Act Upheld

The Illinois State Auditor of Public Accounts refused to grant an operating license to Gadlin's Currency Exchange. Evidence established that Gadlin wanted to start his exchange business in an industrial area, where there were already fourteen currency exchanges, a U. S. Post Office, and a national bank. The court upheld the action of the State Auditor in denying the license. It held that the Currency Exchange Act was constitutional since it was not an unreasonable exercise of state police power, did not contravene due process of law and did not grant special privileges to banks and savings and loan institutions. *Gadlin v. Auditor of Public Accounts et al.*,

Supreme Court of Illinois, 110 N.E. 2d 234. The opinion of the court is as follows:

MAXWELL, J.—This suit was instituted in the superior court of Cook County by Samuel Gadlin, doing business as Gadlin's Currency Exchange, against the Auditor of Public Accounts of the State of Illinois, seeking judicial review of an administrative decision of the Auditor denying the plaintiff a license to operate a currency exchange at a specific location in the city of Chicago. Erie Currency Exchange, Inc., and others were, upon their petition, given leave to appear as intervenor defendants. The superior court rendered judgment affirming the order of the Auditor and the appeal therefrom was taken directly to this court under the provisions of the Currency Exchange Act and because the constitutionality of a section of that statute is involved.

Plaintiff filed an application for a license to operate a currency exchange at 340 West Chicago Avenue, Chicago, and satisfied all requirements of the Currency Exchange Act, (Ill.Rev.Stat.1951, chap. 16½, par. 30 et seq.,) except section 4.1 thereof which was added in 1945 and amended in 1951. Section 4.1, as amended, provides as follows:

> "Upon receipt of an application for a license for a community currency exchange, the Auditor shall investigate the need of the community for the establishment of a community currency exchange at the location specified in the application.
>
> " 'Community', as used in this Act, means a locality where there may or can be available to the people thereof the services of a community currency exchange reasonably accessible to them. If the issuance of a license to engage in the community currency exchange business at the location specified, will not promote the convenience and advantage of the community in which the business of the applicant is proposed to be conducted, then the application shall be denied."

Plaintiff urges that section 4.1 is unconstitutional on the grounds that it is an unreasonable exercise of the police power, that it contravenes the due process clauses of the Federal and State constitutions, that it violates the separation and distribution of governmental powers and the provisions of articles II, IV, V and VI of the Illinois constitution, S.H.A., since it is an unwarranted delegation of legislative and judicial authority to an administrative agency, and that it violates section 22 of article IV of the Illinois constitution as an attempt by the General Assembly to grant special privileges and franchises to individual corporations.

Since this is a judicial review under the Administrative Review Act, no evidence was taken by the trial court. The complaint waived the

filing of a transcript of the evidence taken before the hearing officer, and, at the request of plaintiff defendant included the findings and decision of the Auditor in his answer. The plaintiff does not contend that such findings were contrary to the evidence and they stand admitted for the purpose of this appeal.

Briefly, the facts are as follows: The location sought to be licensed is less than a mile north and two blocks west of the northwest corner of Chicago's loop, it is largely an industrial area containing many large manufactories and warehouses; a substantial number of the businesses pay their employees by cash or furnish check-cashing facilities by armored truck or otherwise; the area contains many old rundown residential properties some of which are vacant and others have been razed; there are five licensed currency exchanges, a U. S. post office and a national bank located within one-fourth mile of the proposed location, one of which exchanges is within one-half block and another is operating at a loss because of a depreciating volume of business; within one-half mile there are fourteen currency exchanges operating; and an exchange formerly in business at the same location closed in 1950 because its operation was unprofitable.

Various private persons, some of whom resided or were employed within one-fourth mile, testified that they made use of facilities similar to those applied for, that they found the existing exchanges convenient and accessible and that they had no difficulty in obtaining currency exchange services.

It is not contended, nor does it appear, that the following findings of the Auditor were arbitrary or unreasonable: that there exists in the area reasonably accessible currency exchanges; and that there presently exists no need for an exchange at the proposed location. The sole and only question therefore, is whether section 4.1 of the Act is constitutional.

The first contention of the plaintiff is that section 4.1 of the Currency Exchange Act is an improper and unreasonable exercise of the police power by the legislature. The right of the legislature to regulate currency exchanges has been passed upon by the court in the case of McDougall v. Lueder, 389 Ill. 141, 58 N.E.2d 899, 156 A.L.R. 1059. The precise question raised here was not there involved since section 4.1 was subsequently added to that Act.

The provisions of the entire act must be read together to determine whether the section in question will promote, or bears substantial relation to, the public health, safety, morals and common welfare. Section .01 dealing with the community currency exchange business, reads in part, "The General Assembly has found and declares . . . that it is affected with a public interest and should be licensed and regulated as a business affecting the convenience, general welfare, and economic

interest of the people of this State; . . . that the number of community currency exchanges should be limited in accordance with the needs of the communities they are to serve, and in accordance with the provisions of this Act; . . ." Other sections of the act provide for a hearing, judicial review and the right of appeal.

Plaintiff stresses the rather narrow view that section 4.1 presupposes that where a community is served adequately any additional exchanges cannot add to its convenience and advantage and that if additional ones cannot add to convenience and advantage of a community already adequately served, they are automatically injurious to the public to a degree sufficient to warrant their exclusion by legislative mandate. Section 4.1 does not prohibit private individuals from establishing and operating a currency exchange business not detrimental to the public, but it does provide a means to insure safe financial practices. The limitation of licenses is merely incidental to the regulation of such business.

While the figures as to number, volume of business and ratio of capital investment are not in the record, they are included in the published reports and public records of the Auditor of Public Accounts. We take judicial notice of such public records. Scofield v. Board of Education, 411 Ill. 11, 103 N.E.2d 640. In 1951 the number of licensed exchanges in Illinois was 597, of which 584 were located in Cook County. The volume of orders issued in that year was over 400 million dollars while the average capital investment was only $9450. For the same year the surety bonds required by the Act represented a coverage of only 79.5 per cent of the average liability. It is evident that during the peak periods of each year, when orders are not cleared rapidly. large amounts of funds are inadequately protected.

It is true that we have held that legislative determination that regulations are needful is not conclusive nor unlimited and in order to be imposed must bear some definite, substantial relation to the public health, safety, morals or public welfare. Zadworny v. City of Chicago, 380 Ill. 470, 44 N.E.2d 426; Klein v. Department of Registration, 412 Ill. 75, 105 N.E.2d 758. On the other hand, we have said that it is a question for legislative determination whether an evil exists and what means should be adopted to prevent it, and its acts will not be interfered with unless they are clearly in violation of some constitutional limitation. Stewart v. Brady, 300 Ill. 425, 133 N.E. 310. The legislative finding is entitled at least to great respect. People v. Chicago Transit Authority, 392 Ill. 77, 64 N.E.2d 4. Nothing in the record indicates that there was no factual justification for this legislation and it has not been shown that there was no room for a legitimate difference of opinion concerning the conditions which prompted it. Where there is room for such a legitimate difference the courts will not investigate the facts for

the purpose of determining whether the declaration was warranted by the facts. People v. Price, 257 Ill. 587, 101 N.E. 196. All presumptions are in favor of the constitutionality of legislation once it becomes the law of the State, and all reasonable doubts must be resolved in its favor. People ex rel. Royal v. Cain, 410 Ill. 39, 101 N.E.2d 74.

The unrestricted issuance of licenses in a community to the point of saturation would tend to decrease the net earnings of each exchange to the point of insolvency of one or more of the exchanges with the inevitable result of losses to the public. We are of the opinion that section 4.1 constitutes a valid exercise of the police power and that its provisions bear a substantial relation to the public safety and financial security.

It is next argued that section 4.1 is, in the use of the terms "convenience," "advantage," and "need of the community", uncertain, vague and indefinite and that it contravenes the due process clauses of the Federal and State constitutions and violates the provisions of the Illinois constitution for the separation and distribution of the governmental powers.

While the legislature, in section 4.1, defined the word "community," it did not attempt to define the words "convenience" or "advantage," nor the phrase "need of the community". No Illinois case comes to our attention where the precise language was in question.

In the case of Jaffe v. Cruttenden, 412 Ill. 606, 107 N.E.2d 715, 718, a section of the Illinois Securities Law exempted from the operation of the statute the resale by a broker of a security acquired in the ordinary course of business. The acquisition and resale price are required to be "reasonably related" to the then current market prices. We there said: "Reasonableness is not, under all circumstances, a prohibited statutory standard. . . . Nor do the cases relied upon by plaintiff preclude the legislative use of the word 'reasonable' in all fields other than those in which its use was sanctioned at common law. . . . That marginal cases may present difficulties does not mean that the language is too ambiguous to define the duties and conditions involved."

In People ex rel. Barrett v. Logan County Building and Loan Ass'n., 369 Ill. 518, 17 N.E.2d 4, 5, where the phrase, "fraudulent, illegal, discriminatory, or unsafe manner" was used in connection with the statute which authorized the Auditor to appoint a receiver and proceed to dissolve an association, we held the language to be sufficiently definite.

In Zurn v. City of Chicago, 389 Ill. 114, 59 N.E.2d 18, we rejected the contention that the Neighborhood Redevelopment Corporation Law failed to fix sufficient standards and constituted an unconstitutional delegation of legislative power. The language there used required determination of certain facts by the Redevelopment Commission: i.e.,

"Slum and Blight Area," the development "designed to effectuate the public purposes" of the act, the plan not to cause "undue hardship" to the families in the area to "such a degree as to outweigh the public use," and not to "displace the predominant primary racial group."

It is difficult to give the words in question in this case a clearer meaning than they carry without definition. The duty imposed upon the Auditor by section 4.1 is to determine two facts. He has no discretion over the conditions, nor is he permitted to create or modify what they are. He merely ascertains and declares what the facts are. We believe that the provisions of section 4.1 are sufficiently definite and that the words in question are not so vague as to delegate legislative authority to the Auditor.

We have said many times that an administrative officer empowered to issue and revoke licenses to engage in a business or profession necessarily exercises quasi-judicial powers, but such exercise is incidental to the duty of administering the law relating to the regulation of a particular business or calling and does not constitute the exercise of judicial power within the prohibition of the constitution. Department of Finnace v. Gandolfi, 375 Ill. 237, 30 N.E.2d 737; People ex rel. Rice v. Wilson Oil Co., 364 Ill. 406, 4 N.E.2d 847, 107 A.L.R. 1500; People ex rel. Mosco v. Service Recognition Board, 403 Ill. 442, 86 N.E.2d 357. The principles enumerated in those cases are applicable to the instant case.

Lastly, it is contended by the plaintiff that section 4.1, in so far as it protects existing currency exchanges against new entrants into the community, violates the constitutional prohibition against laws which grant any special or exclusive privilege, immunity or franchise. The point is made that the legislature has not taken similar action to prevent too many banks, too many building and loan associations or too many savings and loan associations.

The court takes judicial notice of the fact that the growth of currency exchanges has been extremely rapid, while the number of banks and loan associations has remained fairly static. Furthermore, banks and loan associations are subjected to much more rigid supervision, they are required to publish statements of assets and liabilities, most of them are members of the Federal Deposit Insurance Corporation and, in the case of banks, a much larger capital investment is required before they can receive a charter. The legislature is under no duty to extend regulatory measures to all fields in which there may be abuses and it may confine its restrictions to those classes of cases where the need is deemed to be the clearest. People ex rel. McLaughlin v. G. H. Cross Co., 361 Ill. 405, 198 N.E. 356; People v. Loitz, 412 Ill. 313, 106 N.E.2d 338. There is a distinct difference between currency exchanges on the one hand and banks on the other. They are members of different classes of financial institutions. We have often said that laws are

not to be regarded as special or class legislation merely because they affect one class and not another, provided they affect all members of the same class alike. Kloss v. Suburban Cook County Sanitarium Dist., 404 Ill. 87, 88 N.E.2d 89; Keig Stevens Baking Co. v. City of Savanna, 380 Ill. 303, 44 N.E.2d 23.

By inference plaintiff questions the validity of section 25 of the Currency Exchange Act, which provides that all currency exchanges in existence on the date of the passage of the act shall be approved as to location by the Auditor. Similar provisions in other licensing statutes have been held to be a reasonable basis for classification. Elliott v. University of Illinois, 365 Ill. 338, 6 N.E.2d 647; City of Aurora v. Burns, 319 Ill. 84, 149 N.E. 784. We see no merit to the contention that special privilege has been extended to those currency exchanges in business at the time of the enactment of section 4.1.

The judgment of the superior court of Cook County is affirmed.
Judgment affirmed.

Bankers Liable on Letter of Loan Commitment

Defendants, investment bankers, agreed with plaintiff corporation to furnish funds for the construction and initial operation of a garbage disposal plant to be erected in Miami, Florida. Defendants made this agreement orally and by a letter of commitment. Such a financing commitment was necessary before the city would sign a contract to have plaintiff corporation build and operate the disposal plant. When the city signed the contract with plaintiff in reliance on defendant's letter of commitment, defendant refused to acknowledge liability under its agreement and announced that it would not provide plaintiff with funds. The court held that the letter of commitment was a binding contract and that defendant was liable for loss of anticipated profits. *Biothermal Process Corp. v. Cohu* & Co., Supreme Court of New York, 119 N.Y.S. 2d 158. The opinion of the court is as follows:

WALTER, J.—Plaintiff, a New York corporation, formerly called Amity Barter and Trade Corporation, claims that defendant agreed to make available the money necessary for the construction of a garbage disposal plant in Miami, Florida, and adequate initial working capital

therefor, up to $2,600,000, and then failed to do so; and this action is brought to recover the damages alleged to have resulted from such failure.

The questions for decision are whether or not defendant did so agree, and, if so, what recoverable damage has been proved.

More specifically, the claim is that investment bankers committed themselves to the supplying of the money in advance of an agreement as to how the money would be raised. That may sound strange to some persons versed in the ways in which large corporate financing ordinarily is done in the City of New York, but there is nothing impossible or illegal about it, and the question is whether or not that is what was done in this particular case.

What happened in this case is that some persons having to do with the so-called Verdier process for hastening nature's processes of decay and decomposition interested the City of Miami, Florida, in the process as a method of garbage disposal, with the result that on March 16, 1949, Miami's City Commission adopted a resolution approving the Verdier Biothermal Process as a process for the disposal of its garbage and directing the City Manager to enter into negotiations with Florida Caribbean Biothermal Process Co. (frequently referred to as a subsidiary of plaintiff but actually related to plaintiff by reason of the stock of both corporations being owned by the same persons) for a contract between that company and the city—final action to be dependent upon the ability of the company to show commitments for financing the project and approval of the Department of Public Service, the Department of Finance, and the Department of Law.

Negotiations with the city for a contract and with defendant for a commitment for financing then ensued, and defendant was advised of the above mentioned resolution and of the fact that negotiations with the city were in progress.

With that knowledge, defendant on August 11, 1949, signed and delivered to plaintiff (under its then name of Amity Barter and Trade Corporation) a letter which stated that, under certain conditions, defendant was "prepared to undertake the raising and making available of the amounts necessary for the construction of a garbage disposal plant in Miami and to provide adequate initial working capital therefor, up to $2,600,000."

Upon being advised that that wording was not satisfactory because not a binding commitment, defendant signed and delivered another letter in which the phrase above quoted was changed to read "we are prepared to raise and make available," etc.

The complete text of that second letter, dated August 11, 1949, is as follows:

"Cohu & Co.
Investment Securities
One Wall Street
New York 5, N. Y.

August 11, 1949

"Amity Barter & Trade Corporation
c/o Joseph Brill
165 Broadway
New York 5, New York
"*Attention of Dr. Simon L. Ruskin*

"Dear Sirs:

"This is to confirm to you or your assigns our verbal understanding as to the financing of a proposed garbage disposal plant in the City of Miami, Florida.

"1. We understand that through your subsidiary, The Florida-Caribbean Bio-Thermal Process, Inc., you are negotiating a contract with the City of Miami, Florida, of which we have examined a draft, for the erection in or near said city of a garbage disposal plant employing the Verdier Bio-Thermal Process for the disposal of garbage, and for the operation thereof by your subsidiary for a period of fifteen years, subject to certain operations to said city at the end of that period, for an annual consideration of $390,000.00.

"2. We confirm to you that, upon the working out of the details of the contract with the City of Miami in a manner satisfactory to you and to us, we are prepared to raise and to make available to you or your subsidiary of the amounts necessary for the construction of said plant, and to provide adequate initial working capital therefor, up to $2,600,000, through the issuance of obligations and/or stock of your Company or your subsidiary.

"Upon receipt of confirmation by you that you wish us to proceed in this matter, we are prepared, in cooperation with you, to proceed immediately in the working out of the necessary detailed arrangements and agreements covering, among other things, customary commissions or spread to us, expenses, appropriate provision as to compliance with any applicable laws affecting the sale of the securities to be issued, legal approvals, and other mutually satisfactory conditions and provisions customary in underwriting agreements.

"Very truly yours,

Cohu & Co.

By *Charles A. Bianchi*
Partner"

That letter was shown by plaintiff's Florida attorney to Miami officials and apparently was accepted by them as a commitment for financing, for in October, 1949, without other evidence of any commitment, a contract between the City of Miami and Florida Caribbean Biothermal Process Co., Inc., was signed.

Briefly summarized, that contract provides that the corporation will build, upon land supplied by the city, a biothermal garbage disposal plant with a capacity of 900 tons of garbage per working day and convey the same to the city, which would thereupon lease the property to the corporation for a total rental of one dollar. The corporation then to operate the plant at its own expense, receiving $390,000 per year from the city and retaining as its own property all humus or other residual material or by-products. The agreement to last at least 15 years and then a second 15 years unless sooner terminated by the city.

Tacitly at least, if not by express affirmation, defendant and plaintiff both accepted that contract as satisfactory, and insofar as defendant's obligation was conditioned upon the working out of a satisfactory contract with the city, that condition was complied with.

Defendant nevertheless contends that, even if that condition be regarded as performed, its letter is yet nothing more than an agreement to agree and hence not an enforcible obligation.

Plaintiff's answer to that contention is twofold—first, that defendant's letter itself expresses a valid commitment, and, second, that there subsequently was an oral agreement with respect to all the terms which, under any view of the letter, could be regarded as left open for subsequent negotiation. By far the greater part of the evidence upon the trial was addressed to the question whether or not there was such subsequent oral agreement; and after having reserved decision upon defendant's motions based upon the claimed lack of legal obligation in the letter itself. I submitted to the jury the question whether, subsequent to the letter, the parties had arrived at an oral agreement with respect to all the essential terms respecting defendant's raising and making available the money required for the construction of the garbage plant mentioned in the contract with the City of Miami and adequate initial working capital therefor; and the jury has answered that question *"Yes."*

If there be sufficient evidence to sustain that finding, it actually is not material whether or not the letter itself expresses a valid contract; but it happens in this case that there is a close connection between the proper interpretation of the letter and the sufficiency of the evidence to sustain the jury's finding, and for that reason I state my views with respect to the interpretation of the letter.

With the condition respecting the working out of a contract with the City of Miami eliminated, the paragraph numbered 2 of de-

fendant's letter is a confirmation that defendant is prepared to *raise and make available* the amounts necessary for the construction of the plant and to provide adequate initial working capital therefor, up to $2,600,000, through the issuance of obligations and/or stock of plaintiff or Florida Caribbean Biothermal Process Co.; and I think that expresses a binding obligation, and is the "commitment for financing the project" which had been mentioned in the City Commission's resolution of March 16, 1949.

The fact that the exact amount of money to be raised and made available is not stated presents no reason for a contrary conclusion, for the maximum was stated and the actual amount was readily determinable by reference to the requirements of a known project. The rule is well settled that a contract for the sale of goods is not rendered invalid by the fact that the quantity is measured by the requirements of the buyer. Wells v. Alexandre, 130 N.Y. 642, 29 N.E. 142, 15 L.R.A. 218; New York Central Iron Works Co. v. U. S. Radiator Co., 174 N.Y. 331, 66 N.E. 967; Ehrenworth v. George F. Stuhmer & Co., 229 N.Y. 210, 128 N.E. 108; Stern v. Premier Shirt Corp., 260 N.Y. 201, 183 N.E. 363. See also, Manhattan Oil Co. v. Richardson Lubricating Co., 2 Cir., 113 F. 923; Hickey v. O'Brien, 123 Mich. 611, 82 N.W. 241, 49 L.R.A. 594; E. G. Dailey Co. v. Clark Can Co., 128 Mich. 591, 87 N.W. 761; National Furnace Co. v. Keystone Mfg. Co., 110 Ill. 427; Minnesota Lumber Co. v. Whitebreast Coal Co., 160 Ill. 85, 43 N.E. 774, 31 L.R.A. 529; Loudenback Fertilizer Co. v. Tennessee Phosphate Co., 6 Cir., 121 F. 298, 61 L.R.A. 402; Lima Locomotive & Machine Co. v. National Steel Castings Co., 6 Cir., 155 F. 77, 11 L.R.A.,N.S., 713; Marx v. American Malting Co., 6 Cir., 169 F. 582; Golden Cycle Mining Co. v. Rapson Coal Mining Co., 10 Cir., 188 F. 179; Crane v. C. Crane & Co., 7 Cir., 105 F. 869; Walker Mfg. Co. v. Swift & Co., 5 Cir., 200 F. 529, 43 L.R.A., N.S., 730.

Neither is a contrary conclusion required by the fact that when the letter was written, there had been no agreement as to whether the money would be raised through the issuance of stock or through the issuance of obligations, or as to the nature of the stock or the nature of the obligations. The argument of defendant's counsel that there can be no agreement at all until those things are agreed upon seems to me to fail to distinguish between an agreement to raise money and an agreement as to the means by which it shall be raised. I think that the former can exist without the latter, and that an agreement to raise money and make it available is not reduced to the status of a mere agreement to agree by the mere fact that there has been no agreement as to the means by which the money is to be raised. The agreement to agree doctrine is that there must be agreement upon all the essential terms of *a contract*—not that there must be agreement upon all the

things which have a logical or business relation to that contract. An agreement to carry on as partners the business of selling men's clothing at retail is not a mere agreement to agree simply because the parties did not at the same time agree upon the terms of a lease of the particular premises on which the business would be carried on; and here I think defendant's statement that it is prepared to raise and make available the money required for the project up to $2,600,000 is in itself an agreement to raise it and make it available. The effect of the further statement that the money will be raised through the issuance of obligations and/or stock of plaintiff or its subsidiary, it seems to me, is not to render the preceding agreement void, nor even to create such uncertainty as to make specific performance impossible, as is argued by defendant's counsel. On the contrary, the effect of that further statement is to give defendant what was in effect an option to require stock or obligations, or both, of either plaintiff or its subsidiary, or both, and require plaintiff to give whichever defendant elected to require.

The next inquiry then is whether or not the last paragraph of defendant's letter destroys the binding commitment which I find to be expressed in the paragraph of the letter which is numbered 2.

At first reading that last paragraph appears to express many important things which remain to be agreed upon, but closer analysis, I think, shows the first reading to be misleading. "Appropriate provision as to compliance with any applicable laws affecting the sale of the securities to be issued" sounds quite formidable, but in reality it does no more than express what would be implied without expression, viz., that whatever laws affecting the sale of the securities to be issued are decided to be applicable will be complied with. The laws themselves required compliance and there was nothing of consequence with respect to that as to which contractual agreement was required. "Legal approvals" likewise seem to mean nothing more than that such legal approval of the securities as the law requires will be supplied. "Expenses" of course were important, but it seems to me quite absurd to suggest that an agreement to provide the money necessary for a new project is rendered unenforcible because the expenses of the financing are not agreed upon in advance. In the very nature of things, it frequently, if not generally, is impossible to know what the expenses will be until the work is actually done. Advance agreement upon what the charges are to be and who is to pay them frequently may be advantageous, but to say that it is essential seems to me to contradict the most elementary rules of law regarding implied agreements to pay the reasonable value of services rendered upon one's request or for one's benefit.

"Customary commissions or spread to us" seems to refer to defendant's compensation for raising the money, and it might be that agree-

ment on that point was necessary, although it is not clear to me that "reasonable value" might not be the ultimate and a sufficient test even there. In any event, the jury's finding that there was agreement on that subject makes further discussion unnecessary.

Defendant's counsel lays great stress upon the final phrase in the last paragraph of defendant's letter: "and other mutually satisfactory conditions and provisions customary in underwriting agreements".

The evidence establishes, however, that there is no such thing as a "customary underwriting agreement". When a corporation desires to raise money by the issuance of securities and consults investment bankers with respect thereto, counsel for the corporation and counsel for the bankers usually get together and work out a rather elaborate underwriting agreement, and they are in the habit of including in such agreements provisions covering such subjects as both have learned are important. They describe the securities which are to be issued, the prices at which and the time when they are to be offered if there is to be a public offering, the manner in which they will be offered, the price which the underwriter will pay for them if he undertakes to pay for them or the commission he will be paid for selling them if he merely undertakes to endeavor to sell them. They also frequently include, or the underwriter endeavors to include, so-called "outs" or "escape clauses", i. e., provisions that, in the event of certain things happening, the underwriter is relieved of whatever obligation he is assuming. These and many like things are subjects dealt with in many underwriting agreements, but how they are dealt with varies in each instance—so much so that, so far as the evidence discloses, there are no two underwriting agreements which are alike.

The theory of defendant's counsel is that defendant's letter means nothing more than that defendant is willing to discuss a plan for raising money and, because the parties did not eventually agree upon all the subjects which counsel for investment bankers now generally embody in agreements respecting the public offerings of large blocks of securities, there is no basis for the jury's answer of "yes" to the question whether the parties agreed upon all essential terms respecting defendant's raising and making available the money required for the construction of the garbage disposal plant mentioned in the agreement with Miami and adequate initial working capital therefor.

I think defendant's letter means that defendant will raise and make available the money required for those purposes and that instead of arbitrarily dictating defendant's own demands as to the means of raising it, defendant will sit down and discuss what means should be adopted. As defendant had the right to decide the means and also the terms on which these means would be used, failure to agree on those means and

terms was not a failure to agree on the essential terms of defendant's agreement to raise the money.

Defendant pleads several provisions of the statute of frauds. I think an agreement to raise and make available the money required for the construction of a garbage disposal plant and initial working capital therefor is not an agreement for the sale of goods, an agreement to establish a trust, an agreement to pay a commission for obtaining a loan, or an agreement not to be performed within a year or before the end of a life time. Furthermore, I think defendant's letter of August 11, 1949, is such a note or memorandum of the agreement as satisfies the requirements of the statute of frauds.

Defendant next contends that what plaintiff might derive from the operation of the garbage disposal plant cannot be considered as recoverable damages in this case because the plant never was built and hence never was operated. The proposition advanced is that an action will not lie to recover anticipated profits from a new and untried commercial venture. I think that is wholly untenable.

Cases, of course, abound in which recovery of anticipated profits has been refused, and in many of such cases the fact that the source of the anticipated profits had no record of past performances was prominently mentioned; but the rule of the cases is that to justify recovery of anticipated profits the loss of such profits must be satisfactorily proved with reasonable certainty and must have been within the contemplation of the parties, *not* that the newness of the source of the anticipated profits is in itself a bar to the recovery of such profits as were within the contemplation of the parties and are satisfactorily proved.

Here, the contract with defendant was entered into for the purpose of enabling performance of the contract with the City of Miami, as both parties well knew, and this consequently is pre-eminently a case in which the gains which would have been obtained by performance of the contract with the city should be awarded as damages to the extent that such gains have been satisfactorily proved, Witherbee v. Meyer, 155 N.Y. 446, 449, 450, 453, 454, 50 N.E. 58, 59, 60. There is here nothing remote or speculative about the fact that defendant's breach of its own contract prevented gains derivable from performance of the contract with the city: and it cannot even be said that performance of that contract is either a new or untried venture. That particular plant, of course, never was built or operated, and it seems that no similar plant ever has been built or operated in this country, but such plants have been operated in France. This case, therefore, falls well within the general rule that gains prevented as well as losses sustained are recoverable as damages when they were within the contemplation of the parties and are certain in their nature and as respects the cause from

which they proceed, Witherbee v. Meyer, supra, 155 N.Y. at pages 449, 450, 50 N.E. at page 59; and see, also, Delafield v. J. K. Armsby Co., 131 App.Div. 572, 116 N.Y.S. 71, affirmed on opinion below 199 N.Y. 518, 92 N.E. 1083; Czarnikow-Riondo Co. v. Federal Sugar Refining Co., 255 N.Y. 33, 173 N.E. 913, 88 A.L.R. 1426; and the fact that they are uncertain as to amount, *i. e.*, cannot be proved with mathematical certainty, is not a reason for not awarding such as are proved with reasonable certainty. Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 209, 210, 4 N.E. 264, 266; Acunto v. Schmidt-Dauber Co., 207 App.Div. 411, 202 N.Y.S. 1; Alexander's Dept. Stores v. Ohrbach's, 269 App.Div. 321, 328, 56 N.Y.S.2d 173, 179; Nathan v. King Features Syndicate, Sup., 32 N.Y.S.2d 519, affirmed 265 App. Div. 843, 37 N.Y.S.2d 839; Architector Co. v. Slomon, 192 Misc. 319, 80 N.Y.S.2d 590.

The jury has found the damage to be $560,000. Has that been proved with reasonable certainty?

According to the estimate of plaintiff's expert, the cost of operating the plant would be $370,000 per year. Five per cent interest on the estimated cost of the plant is $130,000. The $390,000 yearly payment to be made by Miami is thus $110,000 short of those two items, and on that basis there would be no profit from the operation of the plant unless the so-called humus could be sold for a price exceeding $110,000 per year. The evidence is clear that the operation of a similar plant in Cannes, France, results in reducing the garbage there dealt with to a so-called humus which is valuable and salable as a fertilizer or soil enricher or soil conditioner. The jury reasonably could find that such humus could be sold in America for more than $7 per ton. At that price, 21,500 tons would produce $150,500 or an apparent profit of $40,500 per year, which, for 15 years is $607,500.

Consequently, if there be reasonable basis for a finding that operation of Miami's proposed plant would produce 21,500 tons of humus per year, I think it could not be said that the jury's finding goes beyond reasonable inferences from facts they reasonably could find; and if there be reasonable basis for a finding that some lesser amount of humus would be produced the jury's finding might be reduced accordingly.

The real question, therefore, is whether or not there is a reasonable basis for a finding as to the amount of humus the operation of the Miami plant would produce; and, if so, what amount has reasonable support in the evidence. There is some opinion evidence that city garbage is much the same the world over, with some slight difference that in this country such garbage will produce more humus than French garbage because Americans are more wasteful than French people in the amount and kind of food they throw away. There is also opinion evidence that garbage varies greatly and that in the absence of data as to the nature

of Miami's garbage it is impossible to tell how much humus the operation of Miami's plant would produce. There is here no evidence as to the actual nature of Miami's garbage, and none which I regard as satisfactory as to the probable ratio of humus to garbage, or, in other words, the amount of humus which the operation of Miami's plant would produce; and my conclusion is that because of the lack of evidence as to the nature of Miami's garbage there is no evidence as to the amount of humus the operation of Miami's plant would produce and hence no basis for any finding of any sum as the amount of damage which has been proved with reasonable certainty. This, therefore, is not a case in which the jury's finding as to the amount of damage can be reduced to a sum which the evidence justifies. The only recourse is to set aside the jury's answer to Question three and order a new trial upon the subject of damage.

Mention perhaps should be made of another subject discussed upon the trial. When the contract with Miami was being negotiated serious consideration was given to the question whether electoral approval of the contract was necessary, and at the suggestion of counsel consulted with special reference to the validity of the contract under Florida law, there was inserted in the contract a provision that it was not to become effective until the Florida Supreme Court had rendered a decision holding it valid. Before the time for obtaining such decision had elapsed, defendant denied liability and announced that it would not provide the money. Compliance with the requirement for obtaining such decision was thereby waived, and as a condition precedent to the effectiveness of the contract the requirement passed out of existence.

That of course does not mean that plaintiff was relieved of the necessity of proving ability to perform, but it does mean that a decision of a Florida court as to the validity of the contract is not an essential element of such proof. I suppose that in every action in which the claim is made that defendant's breach of the contract sued on has deprived plaintiff of gains he would have obtained by performing another contract performance of which has been prevented by defendant's breach, the court trying the case must decide, not necessarily that the contract performance of which by plaintiff was prevented by defendant's breach was definitely valid, but that it had at least such apparent validity as to authorize a finding that gains would have been obtained by performance thereof. That may mean that I erred in taking the testimony as to Florida law in the absence of the jury and then telling them that in considering damage they could consider that the contract with Miami might be declared invalid under Florida law. But if so, it was an error in defendant's favor because it gave the jury the right to consider possible illegality as a reason for fixing the damage at a smaller amount than they would fix if the possibility of illegality had not been suggested

to them. I think it also may be said that if I erred in that respect, it was an error into which defendant's counsel led me by first suggesting that the testimony as to Florida law should be taken in the absence of the jury and then persuading me that I should permit the jury to consider the possible invalidity of the contract.

Nothing that any New York court may say or hold with respect to the validity of the contract will be binding upon any Florida court before which the question subsequently may come (unless, perchance, the circumstances be such as to justify invocation of the doctrine of res judicata or of the full faith and credit clause of the United States Constitution); but as my submission of the question of damage to the jury implies at least a holding that the contract is at least apparently or presumptively valid, I perhaps should state why I am of the opinion that it is valid.

Section 167.06 of the Florida Statutes, F.S.A., provides that the council of any city of the state may enter into an agreement with any individual or corporation for the gathering and disposal of its garbage upon such terms and for such period of time, not to exceed thirty years, as may be agreed upon; *provided that* if such agreement involve a greater annual cost to said city than it is *now paying for the same quality or amount of service*, said agreement shall be ratified by a majority of the votes of the freeholders of the city voting at an election to be held for that purpose.

The word "now" in the phrase "now paying for the same quality or amount of service" has obvious ambiguity. Grammatically, it refers to the time when the statute was enacted, but I think the meaning is that electoral approval must be had when a city decides to embark upon a plan for garbage disposal which is to cost it more than the plan it is then using, that the word "now" consequently is to be read as referring to the time when the new plan is embarked upon, but that in determining whether the cost of the new plan is or is not greater than the cost of the existing plan regard must be had, not solely to the cost at one precise moment but, also, to the cost over a reasonable period of time. Under that view, the necessity for electoral approval depends upon questions of fact respecting comparative costs of two methods of garbage disposal over a reasonable period of time. Under the evidence here I conclude that this contract would not cost Miami more than the cost to it of the garbage disposal methods it was using when the contract was made and that therefore electoral approval was not necessary.

Section 6 of Article 9 of Florida's constitution, F.S.A., provides that municipalities of the State shall have power to issue bonds other

than refunding bonds only after the same shall have been approved by a majority of the votes cast in an election in which a majority of the freeholders who are qualified electors residing in the municipality shall participate; and in Leon County v. State, 122 Fla. 505, 165 So. 666, 667, the Supreme Court of Florida said that a "bond" within the meaning of that constitutional provision includes "Any contractual device for the present funding of tax revenues contemplated to be raised or made available for reimbursement in future years, contrived to be issued as an enforceable legal security to the obligee, or his assignee, by means of which such obligee or his assignee will acquire a legal or equitable right to coerce by judicial processes the repayment of a sum of money advanced on the strength thereof, together with interest for the hire of the amount advanced, however calculated or provided, to be paid upon the sum so involved".

Here, however, there is no present funding of tax revenues, there is no sum of money advanced, there is no provision for the payment of any money for the hire of any money. All that we have here is an unsecured promise by Miami to pay a stated sum of money per year over a period of not in excess of 30 years. There is nothing remotely resembling a bond even under the broad definition of a bond given in the Florida case just cited. I hence conclude that electoral approval of this contract was not required by this provision of Florida's constitution any more than such approval was required by the section of the Florida statutes above mentioned; that the contract is valid without electoral approval; and that the Florida Supreme Court would have so held if the question had been presented to it.

Another possible source of invalidity suggested is with respect to Miami's debt limit; but there is no evidence whatever which permits any finding of any illegality on that ground and in the absence of such evidence I think a presumption of legality must be indulged.

Defedant's motions to dismiss the complaint, to direct a verdict in its favor, and to set aside the jury's answer of "Yes" to Question No. 1, are all denied. The motion to set aside the jury's answer to Question No. 3 is granted and a new trial ordered on the question of damages only. See Gasoline Products Co. v. Champlin Co., 283 U.S. 494, 51 S.Ct. 513, 75 L.Ed. 1188; 16 Minn.Law Review 185, 193; 33 Harv. Law Rev., 249, 250; 34 Harv. Law Rev., 71, 73.

Each party is deemed to have excepted to each adverse ruling.

No Interest Owed on Bank Stockholders' Statutory Liability

The Chicago Bank of Commerce was closed by the state auditor and suit was instituted by bank creditors to enforce stockholders' liabilities. Stockholder Joslyn, who owed $57,000, was adjudicated bankrupt before paying his share but ten years later his bankruptcy proceedings were opened for reconsideration. On appeal in that case it was determined that Joslyn should have included certain assets in his bankruptcy schedules; however, it was pointed out that his omission was the result of a mistake of law. The amount owed by Joslyn was paid to the bank's stockholders who had overpaid on their shares in the original bank proceeding because of Joslyn's purported inability to pay. Subsequently, the bank's creditors claimed that interest should have been paid on the $57,000 from the time Joselyn's bankruptcy proceedings began. The court held there was no statutory, constitutional or equitable reason for requiring the payment of interest. *Hillmer et al. v. Chicago Bank of Commerce et al.,* Appellate Court of Illinois, 111 N. E. 2d 194. The opinion of the court is as follows:

NIEMEYER, J.—The Benevolent and Protective Order of Elks of the United States of America, a corporation, and John Marshall Law School, a corporation (hereinafter respectively called the Elks and Law School), creditors of the insolvent Chicago Bank of Commerce, appeal from five orders entered in this cause, a creditors' suit to enforce the constitutional and statutory liability of the stockholders, as follows:

(1) Order entered July 12, 1951, permitting M. L. Joslyn to file his petition offering to pay $57,100 in full settlement of the liability of his son George R. Joslyn (hereinafter called Joslyn), a stockholder defendant.

(2) Order of July 18, 1951, approved by plaintiffs and certain defending stockholders (hereinafter referred to as overpaying stockholders), accepting the offer; finding that said sum had been paid to the receiver in open court; ordering and decreeing that the rights, claims, etc., of each and every creditor against Joslyn arising because of his ownership of stock in the bank be and the same are thereby satisfied in full and completely discharged; permanently enjoining and restraining each and every creditor of the bank, their agents and attorneys from insti-

tuting and from prosecuting any claims, demands, actions, causes of action, proceedings at law or in equity against Joslyn on account of any claim, demand, debt or right because of ownership of stock in the bank.

(3) Order of August 22, 1951, ordering that the receiver pay and distribute to Wade Fetzer, Jr., and other stockholders (hereinbefore referred to as overpaying stockholders) $50,972.79, the balance of the refund to which they were entitled under decree entered February 14, 1950 finding that the stockholders named therein had made overpayments totaling $145,636.56 on their liability and imposing a trust, for the use and benefit of the overpaying stockholders, upon all the funds then in the possession of the receiver and all moneys to be thereafter received by him on account of liabilities of stockholders after payment from said funds and moneys of all the costs and expenses of the receivership.

(4), (5) Orders entered September 20, 1951 (a) modifying the provisions of the order of July 18, 1951 enjoining and restraining the creditors of the bank, their agents and attorneys; (b) denying leave to the Elks and Law School to file their respective petitions presented September 13, 1951.

Thomas Hart Fisher, one of the attorneys for the Elks but not a party to the record, appeals from the order of July 18, 1951 and the order of September 20, 1951 modifying the prior order.

The bank commenced business April 5, 1930. June 25, 1932 the Auditor of Public Accounts closed it and instituted liquidation proceedings. On the same day Armin F. Hillmer and others, as representatives of all creditors of the bank, instituted this suit to enforce the liabilities of the stockholders to the bank creditors. May 9, 1934 an amended and supplemental complaint was filed alleging, among other things, that the defendant Joslyn was the owner of record of 1142 shares of the par value of $50 per share from February 10, 1932 to June 25, 1932 and is liable to the creditors of the bank for the aggregate par value of his stock, or $57,100. In 1936 Joslyn filed a petition in bankruptcy, was adjudicated a bankrupt and discharged. September 16, 1938 he filed his answer herein, setting up his discharge in bankruptcy.

The bankruptcy proceedings were reopened May 20, 1946 on petition of the Elks as a depositor in and creditor of the bank, alleging fraudulent concealment of assets and fraudulent misrepresentation of creditors in the sworn bankruptcy schedules, In re Joslyn's Estate, 7 Cir., 171 F. 2d 159; Young v. Handwork, 7 Cir., 179 F. 2d 70, 16 A. L. R. 2d 825. On the same day, "in order to preserve the estate and to prevent loss thereto," all persons were enjoined from in any manner prosecuting any action or suit against Joslyn or against any of his assets without leave of court. June 30, 1950 Joslyn filed his petition praying that his stock-

holder's liability be determined and that he be permitted to pay all claims and the costs, fees and expenses assessable against the bankrupt estate. The trustee in bankruptcy answered the petition. He also filed a set-off and counterclaim. The overpaying stockholders intervened, setting up a preferred claim of $50,972.97—balance of refund due under decree entered herein February 14, 1950. Hillmer on his own behalf and as representative of all other creditors of the bank filed a claim, based on Joslyn's liability as a stockholder, for $57,100 and legal interest at 5 per cent from the adjudication of Joslyn as a bankrupt in 1936. The referee reported March 16, 1951, recommending that the claim against Joslyn because of the ownership of stock in the bank be determined in this cause and that the claim as determined herein be filed, allowed and paid in the bankruptcy proceeding. While the report was under advisement judgment for $57,100 was entered in this cause against Joslyn, paid by his father, and all liability of Joslyn as a stockholder satisfied in full and completely discharged on July 18, 1951. November 8, 1951 this settlement and adjustment of Joslyn's liability as a stockholder was approved by the bankruptcy court and the petition of the overpaying stockholders held to be a matter to be determined in this cause. In re Joslyn, D. C., 102 F. Supp. 521, affirmed 7 Cir., 198 F. 2d 673, certiorari denied by Supreme Court of the United States, Benevolent and Protective Order of Elks v. Joslyn, 73 S. Ct. 640. On August 22, 1951 an order was entered herein, directing payment to the overpaying stockholders of $50,-972.79, the balance of the refund due said stockholders under the decree of February 14, 1950.

September 13, 1951 the Elks asked leave to file its petition herein, alleging among other things the foregoing matters and proceedings and praying that the orders of July 18, 1951 and August 22, 1951 be vacated, set aside and declared to be null and void for all purposes, and that the receiver be ordered to make no further distribution of said sum of $57,100 until further order of court. On the same day the Law School asked leave to file its petition, alleging full payment and satisfaction of the decree of February 14, 1950 and praying for a decree that the claims of the overpaying stockholders have been fully satisfied of record. Leave to file the petition was denied September 20, 1951, and that part of the order of July 18, 1951 restraining and enjoining the creditors of the bank, their agents and attorneys from instituting and prosecuting any claims, etc., against Joslyn on account of ownership of stock in the bank was modified by adding thereto a provision that said creditors, their agents and attorneys, are not enjoined and restrained from prosecuting their rights in the Joslyn bankruptcy proceeding, but that said creditors are individually and severally permanently enjoined and restrained from claiming or asserting in said bankruptcy proceeding that the liability of Joslyn by reason of his ownership of stock in the bank,

including liability for interest, if any, exceeds $57,100 heretofore paid to the receiver herein, and from claiming or asserting in said bankruptcy proceeding that the stockholder's liability of Joslyn has not been released and satisfied in full pursuant to the order of July 18, 1951.

The order of July 18, 1951 (hereinafter called the settlement order) authorized settlement of Joslyn's liability as a stockholder by payment of $57,100, the aggregate par value of stock owned by him. The settlement was executed by payment of the required sum and the satisfaction and discharge of Joslyn's liability. The money was paid by his father. It was never an asset of Joslyn or under the control and jurisdiction of the bankruptcy court. The settlement was approved by the bankruptcy court, 102 F. Supp. 521, and the Court of Appeals, 198 F. 2d 673. Certiorari denied by the Supreme Court of the United States March 9, 1953, 73 S. Ct. 640. The Elks and the Law School (hereinafter called petitioners) contend that Joslyn should have been charged with interest at 5 per cent per annum from the commencement of the bankruptcy proceeding in 1936, more than $40,000. No provision of constitution or statute supports petitioners' claim. We know of no Illinois case in which interest has been added to the amount found due from a stockholder. Each reported case affirms the rule in equity allowing interest in a proper case, although not within the precise terms of the statute, if its allowance is warranted by equitable considerations. Interest was denied in these cases because the facts did not establish equitable considerations necessary to the allowance of interest. Thus, in Lewis v. West Side Trust & Sav. Bank, 376 Ill. 23, 32 N. E. 2d 907, it is specifically stated that there is no claim of fraud as a reason for the allowance of interest, and that vexatious delay is not shown. Petitioners base their claim on vexatious delay, effected by fraudulent concealment of assets and creditors in the bankruptcy proceeding.

Reconstruction Finance Corp. v. Pelts, 7 Cir., 123 F. 2d 503, was an action to enforce the liability of bank stockholders. The nominee of Pelts, without interest in the stock and presumably without financial responsibility, was a stockholder of record. She was made a defendant. Without disclosing his interest, Pelts secretly financed and directed her defense. After a decree had been entered against her, Pelts' ownership of the stock was discovered and a decree obtained against him, with interest from the date of the decree against his nomineee. In sustaining the decree the court said, 123 F. 2d at page 505:

> "The appellant knew he was the real owner of the stock in question, and that the liability was his. Nevertheless, he provided attorneys to defend Edith Levinson's case, and stood by and saw judgment go against her, when he knew it was his liability. It may be true that he was under no duty to speak up and assume that liability. He committed no legal offense when he kept still

and let judgment go against Edith Levinson, when he knew that it ought to have been against him; but he is certainly in no position to complain when he is discovered, or to ask a court of equity not to charge him with interest."

McKey v. McCoid, 298 Ill. 566, 132 N. E. 233, was a creditor's suit in which an insolvent husband was shown to have paid certain moneys to or for the benefit of his wife. In affirming the refusal of the Appellate Court to charge her with interest, the court said, 298 Ill. at page 572, 132 N. E. at page 235:

"While it is immaterial in determining whether or not there was constructive fraud or fraud in law as against creditors in the payments made (Harting v. Jockers, 136 Ill. 627, 27 N. E. 188, 29 Am. St. Rep. 341; Marmon v. Harwood, 124 Ill. 104, 16 N. E. 236, 7 Am. St. Rep. 345), it does affect the question as to whether or not defendant in error would have a right to have interest charged on the amount found to have been paid by the insolvent husband for the benefit of the property of Mrs. McCoid. There is no evidence that she received the sums paid to her for the purpose of aiding McCoid to defraud his creditors. The rule followed in equity is to allow interest where warranted by equitable considerations, but where such allowance does not comport with justice and equity it may be disallowed. Golden v. Cervenka, 278 Ill. 409, 116 N. E. 273."

Joslyn was a beneficiary of two trusts, created respectively by his father and mother. He did not schedule his interest in these trusts in the original bankruptcy proceeding. When that proceeding was reopened ten years later, he scheduled his interest without prejudice to his right to assert that such interest was not administerable in the bankruptcy court and was not subject to the payment of his debts. In a suit by the trustee in bankruptcy the trial judge sustained Joslyn's contention. He held that Joslyn's interest in the trusts was not property within the meaning of section 70 of the Bankruptcy Act, 11 U. S. C. A. § 110, and that his interest in the trusts and in the income therefrom in the hands and under the control of the trustees of the trust, was clearly within the protection of section 49 of the Chancery Act, Ill. Rev. Stats. 1951, chap. 22, and could not be reached by creditors nor by the bankruptcy trustee acting in their behalf. These holdings were reversed on appeal, 179 F. 2d 70, and Joslyn's interest was held to be property within the meaning of the bankruptcy act, transferable by him and administerable in bankruptcy. So the necessity of scheduling Joslyn's interest in the trusts was a question as to which men learned in law differed. Mistake of law is not fraud. No presumption of fraud arises from the failure to schedule the interest in the trusts or from the reopening of the bankruptcy es-

tate. Discovery of substantial unadministered assets, however innocently omitted from the schedules, would require reopening of the proceedings so that complete administration of assets might be had. U.S.C.A., Title 11, Bankruptcy, sec. 11. There is neither allegation nor proof in the petitions presented for filing herein of any fact tending to establish fraud in the bankruptcy proceeding, either in the listing of assets or the person or persons to whom Joslyn's liability as a stockholder was owing. The charge of fraud fails. Merely appearing and defending this suit is not vexatious delay. Lewis v. West Side Trust & Sav. Bank, supra. Consequently, there are no equitable considerations warranting allowance of interest.

This conclusion effectively disposes of all objections to the settlement order. There was no compromise of Joslyn's liability. The amount obtained by the settlement was the maximum amount recoverable under the constitution and the statute—the aggregate par value of the stock owned by Joslyn. Neither petitioners nor any other creditor of the bank sustained any loss or damage as a result of the settlement. It is, therefore, immaterial whether Hillmer and other creditors, plaintiffs herein, had authority to consent to the order. Because of the approval of the settlement by the federal courts and the remandment of the overpaying stockholders to the state court for determination in this case of their rights to payment of the balance claimed by them under the decree of February 14, 1950, the extended argument as to the paramount and exclusive jurisdiction of the bankruptcy court is no longer relevant.

The order of August 22, 1951 directed payment to the overpaying stockholders of $50,972.79, the balance of the refund due them under the decree entered herein February 14, 1950 fixing the aggregate overpayments of the stockholders named therein at $145,636.56 and directing repayment to the respective stockholders of the amount overpaid by them. No appeal was taken from that decree. It is now final. The amounts therein decreed to be due the respective stockholders cannot now be changed or modified. The contention of petitioners that a percentage of the costs and expenses of prosecuting this suit be deducted from the amount fixed in the decree as owing to the respective stockholders, is an attempt to modify the decree and is wholly without merit.

Petitioners have no interest in the amount found to be due the attorneys for the overpaying stockholders, as these amounts are to be deducted proportionately from the amount due the interested stockholders.

Only the interested stockholders can complain. There is no error in the order of August 22, 1951. Neither is there error in denying leave to file the petitions presented by petitioners.

Thomas Hart Fisher is not a party to this suit. He is not a creditor of the bank. His only interest is as attorney for the Elks. This is not an appealable interest, and his appeal is dismissed.

Because of the later decisions in the federal courts, heretofore cited, affirming and approving the settlement of Joslyn's liability as á stockholder under the order of July 18, 1951, that part of the injunction order of September 20, 1951, purporting to limit the claims to be made by the creditors of the bank in the Joslyn bankruptcy proceedings is now moot. We do not determine the objections made to the order.

Appeal of Thomas Hart Fisher is dismissed: all orders appealed from are affirmed, except injunction order of September 20, 1951.

FRIEND, P. J., and BURKE, J., concur.

BANK SUED FOR CONTRIBUTING TO DEPOSITOR'S DEATH

It has been reported recently that the wife of a depositor in New Jersey has filed suit of $100,000 against her husband's bank for contributing to his death. The complaint alleges that the bank mistakenly deducted $182 from the husband's account. When his checks were returned for insufficient funds because of this mistake he suffered mental anguish which caused a fatal heart attack. The bank reportedly admits the error in computation but denies liability for causing the depositor's death.

TRUST DECISIONS

Digest of current decisions pertaining to the law of trusts, wills, estates, descent, distribution and corporate fiduciaries

U. S. Savings Bonds Not Improper Investment for Common Trust Fund

In re Continental Bank and Trust Company; In re First Discretionary Common Trust Fund, 129 N.Y.L.J. 1280, April 17, 1953

On an accounting by a corporate fiduciary at the time of dissolving a common trust fund, objections were raised that it was improper and imprudent for the trustee to have invested in United States Savings Bonds, Series G since if the bonds were redeemed the interest rate would have to be adjusted downward for the shorter term. The court held that such an investment was not improper or imprudent since the trustee fully expected to retain the bonds for the entire interest period at the time the investment was made. Unforseeable circumstances required the dissolution of the trust fund at the time of the present accounting.

Uniform Common Trust Fund Act

The Uniform Common Trust Fund Act which was approved by the National Conference of Commissioners on Uniform State Laws in 1938 has now been enacted in fifteen states and the District of Columbia. There are in addition twenty-eight states which have enacted complete and detailed Common Trust Fund Acts or statutes permitting trustees to invest in common trust funds.

The Uniform Common Trust Fund Act enables banks or trust companies to form common funds for trust investment. The Act does not specify details of operation of such funds except to designate that the funds be made up of securities legal for trust investment in the state where the Act is adopted. The details of operation are set forth in Federal Reserve Board regulations which are generally followed so that the common fund will qualify for income tax benefits. The following states and the District of Columbia have adopted the

Act: Arizona, Colorado, Florida, Idaho, Mississippi, New Hampshire, North Carolina, Oregon, South Dakota, Tennessee, Texas, Utah, Washington, West Virginia and Wisconsin.

Congressional Committees Given Power to Inspect Tax Returns

53 Stat. 467, 26 United States Code 3791, April 22, 1953

A recently passed federal statute gives the Senate and House Committees on the Judiciary power to inspect any income, excess-profits, declared value excess-profits, capital stock, estate or gift tax returns necessary to the administration of the Trading With The Enemy Act. The Senate Committee is empowered to inspect such returns for the years 1941 to 1952 inclusive and the House Committee, to inspect returns of any year to 1952 inclusive.

Trustee Permitted to Use Income to Operate Decedent's Business

Holmes v. Hrobon, Ohio Supreme Court, February 4, 1953

A laundry business was left in trust by decedent whose will gave the trustee full power to carry on the business until it could be sold at a reasonable price. Trust income was to go to decedent's wife during her life. The laundry had always been operated out of earnings and consequently the trustee was provided with no capital to operate or expand the business. The Ohio Court held that the trustee could use income from the laundry to operate and expand it since that is what decedent must have intended. The income could be used in this way so long as the business was operated profitably and the widow received a reasonable income.

Trustee May Set Up Depreciation Reserve from Real Estate Income

Matter of City Bank Farmers Trust Company, Appellate Division, Supreme Court of New York, 281 App. Div. 905

Four trusts owned all the shares of corporations which owned certain parcels of real estate. Over a vigorous dissent the Court ruled that it was proper for the trustee to deduct from real estate income a sum for depreciation reserve.

Decedent's Wish Regarding Executor's Compensation Not Mandatory

Third National Bank v. Cohn, Tennessee Supreme Court, 254 S.W. 2d 741

A bank and two individuals were named in decedent's will as co-executors and co-trustees. Decedent had made an agreement with the bank to the effect that it would receive as compensation 2½% of the gross income of the estate if Cohn acted as co-trustee but would receive 5% if he did not. The will provided that it was decedent's "wish" that the individuals who served as fiduciaries would not charge for their service. After Cohn had served as executor and trustee, he applied for compensation. The court ruled that the word "wish" in decedent's will did not make it mandatory that Cohn serve without compensation and that therefore he was entitled to be paid for his services.

Decedent Makes Bequest by Signed Check

Old Ladies' Home Association v. Miller, Mississippi Supreme Court, April 6, 1953

At the time of making her will, decedent wrote a check payable to her brother leaving the amount blank. This check was attached to her will which read in part "a check written to A. T. Miller and signed so can check out balance in bank." The court ruled this provision was an unlimited bequest to the brother of decedent's entire bank account.

Writing on Promissory Notes Given Effect at Death

Estate of Smith; Fischer v. Fischer, Iowa Supreme Court, May 5, 1953

Decedent had written on two promissory notes, "If payee departs this life before this note is paid same is hereby fully cancelled and executor instructed to deliver same to payor." The executor claimed that despite this writing the notes were part of decedent's estate and should not be cancelled. The court ruled against the executor. It found the notations on the notes were part of the written instruments which were enforceable contracts with valid provisions for cancellation.

TAX DECISIONS

Digest of current decisions pertaining to the law of taxes on banks, trusts, estates and gifts

Gift Tax—Annual Exclusion Not Permissible for Gifts of Future Interests

Cadwell Tyler, II v. Commissioner, U. S. Tax Court, 12 T.C.M. April 16, 1953

Taxpayer created four trusts for the benefit of his four minor children. His wife was to receive the income for the benefit of each child; when each child reached the age of 21 the income would be paid over to him until he reached 35 at which time he would receive the whole corpus of the trust. The wife was given the power to encroach upon the corpus of the trusts for the benefit of the beneficiaries.

The Tax Court held that since the enjoyment of the trust prinicpal was deferred until each child reached 35, the taxpayer made a gift of a future, not a present, interest and thus he could not take advantage of the annual $3000 gift tax exclusion. Likewise, the court, held that since the wife had the power to encroach upon principal, the present interests of *income* were incapable of evaluation and thus the exclusion was not permissible in respect to the gifts of income.

Income Tax: "Total Conpensation" Includes Trustee's Principal and Income Commissions

W. Harold Warren v. Commissioner, 20 T.C. No. 49, May 19, 1953

Taxpayer, a trustee, received in one year certain commissions on the principal of a trust which he had administered for some eight years. During the same year he received certain income commissions but together these commissions did not equal 80% of the total principal and income commissions received during the trusteeship. Taxpayer claimed the principal commissions should be considered separately from income commissions. This would permit him to take advantage of I.R.C. Section 107 which allows certain income tax benefits if at least 80% of a taxpayer's compensation for personal services rendered over a period of thirty-six months or more if received in one year. The court

ruled that taxpayer did not qualify for the tax benefits since 80% of taxpayer's "total compensation" must be received before the statute applies and "total compensation" includes both principal and income commissions.

Cost of Annuity Is Income to Employee

Gott v. Commissioner, U. S. Tax Court, 12 T.C.M., April 22, 1953

Clock Company agreed to sell all its stock to Manville Corporation. Pursuant to this agreement, Clock Company was to buy an annuity for taxpayer, its vice president, at the time Clock Company changed hands. The annuity cost $41,000 and taxpayer was made beneficiary. When he claimed this amount was a gift to him paid out of the proceeds of sale of the stock, the Tax Court ruled against him. This was not a gift. The whole cost of the annuity was taxable to taxpayer as income for services rendered.

Life Insurance Premium Paid by Creditor Bank Deductible

The Charlestown National Bank v. Commissioner, U. S. Tax Court, 20 T.C. No. 30, April 30, 1953

Certain debtors assigned their life insurance policies to a creditor bank as collateral security. The bank paid the premiums on the policies to protect its security and in hope of recovering part of the indebtedness. The Tax Court held the premiums paid were deductible as ordinary and necessary business expenses.

Bank Neglecting to Claim Deduction for Reserve for Loans Receivable

Union Bank of Commerce Company v. Peck, Ohio Board of Tax Appeals, April 7, 1953

A corporation in Ohio failed to make a claim for allowance of a reserve against loans receivable in its franchise tax reports as required by Ohio statute. Such failure does not give rise to a refund usually allowed for taxes illegally or erroneously assessed.

Estate Not Liable for 5% Penalty Where Attorney Filed Estate Tax Return Late

Estate of Fisk v. Commissioner, U. S. Court of Appeals, Sixth Circuit, April 16, 1953

An executrix turned the preparation and filing of a federal estate tax return over to an attorney who failed to mail the return until the day it was due. The court held that although the return was not filed within the time prescribed by statute, the 5% penalty for untimely filing should not be imposed since the estate representative had not acted unreasonably in employing counsel to attend to tax matters.

Reciprocal Tax Statutes Permit Collection of Domiciliary Inheritance Taxes on Nonresident Estates

Twenty-one states have now enacted reciprocal statutes designed to prevent evasion of inheritance taxes on intangible property levied by the state of decedent's domicile. The statutes provide that the state authorities where a nonresident estate is being administered will notify the tax authorities in the state of decedent's domicile so that the domiciliary taxes may be collected. Such statutes have been enacted in the following states: Arkansas, Colorado, Connecticut, Delaware, Kentucky, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Virginia and Washington.

Promissory Notes Are Not Taxable Debentures

Leslie Salt Co. v. United States, United States District Court, California, 110 F. Supp. 680

A federal statute, (26 U.S.C.1801) imposes a stamp tax on all "debentures" issued by any corporation. Plaintiff corporation borrowed large sums from two insurance companies. In return it gave the insurance companies promissory notes and executed agreements with them limiting its financial activities so as to safeguard repayment of the loans. The District Court overruled the Collector and held that such promissory notes were not debentures taxable under this section of the statute.

INVESTMENT AND FINANCE

Edited by OSCAR LASDON

Treasury Refunding

REDUCTION of the Treasury's large floating debt is a desirable objective, but large-scale refunding into long-term bonds with higher rates of interest may not be the best idea right now. This conclusion is voiced in a bulletin, "Refunding the Public Debt," released by the Institute of International Finance of New York University. The survey points out that such a refunding procedure, under present circumstances, could have a detrimental effect on the economy. Business activity could be influenced adversely and the nation might be saddled, for years to come, with higher rates of interest and an increasing debt burden which might prove unwarranted.

Is the lengthening of maturities of Federal obligations a pressing problem? The bulletin thinks not. It declares that no special urgency to reduce the volume of bank-held debt exists, inasmuch as business activity and the price structure have caught up with the supply of war-created deposits. With respect to the large amount of floating debt held by non-bank investors, attention is directed to the reasons why such obligations are retained; short-term issues have attraction because they are useful for liquidity purposes, quarterly tax payments, and are held in anticipation of higher interest rates on long-term issues. Therefore, it is stated, there is little danger that the Treasury will run into difficulties because of the frequent need of refinancing large amounts of maturing obligations; their replacement by other short-term issues at prevailing rates can always be effected.

Of course, a possible disadvantage of a large floating debt is that the Treasury, at times, may have to pay a high rate. On the other hand, if the newly issued obligations are also of short maturity, this higher cost will be incurred for only a short period. And constant refunding operations, we are reminded, interfere with the credit policies of the Federal Reserve authorities.

The bulletin outlines the possible impact of refunding on the money and capital markets. For example, should refunding result in a material reduction in the supply of short-term Governments held primarily for liquidity purposes, it could lead to a widening in the yield spread between the short and long-term sectors of the market. Continued institutional bidding for bills, certificates and other obligations with maturities of not more than a year would persist as long as such securities are required to insure liquidity. And should the supply be reduced, a decline in the yield of such short-term obligations would result. On the other hand,

an increase in the supply of medium and long-term issues might lead to an increase in the return on those securities.

Furthermore, a large-scale refunding operation which reduced the volume of Governments held by commercial banks could lead to a decline in the volume of bank deposits. It could also affect the money supply through its impact on the volume of reserve balances, and the loss of reserves by member banks would reduce their lending and investing ability. Such a policy, states the bulletin, is desirable during a period of inflationary pressures caused by a rapid expansion of bank credit. But it asserts that such a policy is not now desirable since the present situation is one in which business is on dead center, with deflationary forces appearing on the horizon.

The bulletin declares that the adoption of a long-range refunding policy in the immediate future is not advisable. It contends that the rise in interest rates that has occurred in the last two years is a temporary cyclical movement accruing from the aftermath of the Korean war, the spending of billions on rearmament, the expansion of defense and defense-supporting industries, and the changed open-market policy of the Federal Reserve authorities.

Additional conclusions reached by the study are the following:

1. Aggressive competition by the Treasury with private borhowers, through the offering of a higher rate of return on new issues, leads to a general increase in long-term rates but does not necessarily make Treasury obligations more attractive to ultimate investors. Thus, successful Treasury operations would involve an upward pursuit of the market, and the payment of increasingly higher rates on medium and long-term issues.

2. Such a policy leads to a decline in prices of long-term Governments and causes considerable depreciation in the portfolios of institutional investors. In turn, a further impairment of the stability and marketability of Treasury issues results, and they become less attractive to these investors.

3. Under such circumstances, even a small spread between the yields of Governments and corporate high-grades of similar maturity may induce institutional investors to favor the latter.

4. As long as the Treasury is confronted with the task of raising new money to finance current deficits, and the Reserve authorities pursue a policy of credit restraint, the successful consummation of large-scale refunding operations will not be possible. Accordingly, for the time being, the Treasury may be compelled to adopt a policy of offering short-term issues, which have considerable corporate attraction.

5. While tight money conditions exist, the advisability of the Treasury following the market by offering higher rates is questionable. A policy which results in a disruption of the high-grade bond market and increases the debt burden is not warranted by the raising of a relatively small amount of money.

This study was directed by Dean G. Rowland Collins and Professor Marcus Nadler.

Personal Trusts and Estates

A corporate trustee has many advantages over an individual trustee, states Harold H. Helm, president of the Chemical Bank & Trust Company of New York. Where is it possible, he asks, to acquire in an individual—no matter how experienced—the following essential requirements.

1. Continuity of management—without the expense and adjustments that result from the death of an individual trustee.

2. Practically unlimited financial responsibility.

3. Personnel experienced in the many complex problems of administration, such as investments, income taxes and accounting.

4. Availability unhampered by vacations, sickness or business trips.

There is, he concedes, an old and continuing criticism that banks, acting in fiduciary capacities, proceed with an excess of caution that hobbles them in their activities. This criticism proceeds along the vein that banks are so afraid of losses that the beneficiaries are precluded from making any gains. The basis for this criticism arises from some former feeling that the function of trustees was to conserve rather than create wealth; that trust officers were believed to be devoting themselves to the sole objective of preserving the same dollar value. As a matter of fact, Mr. Helm observes, one of the bases for the appointment of individuals instead of banks as fiduciaries—and of individuals along with banks—seems to have been the prevention of investment of the fund in "super-safe, low yield securities."

"We must be careful," declares the Chemical trust officer, "not to ever give the impression that to avoid a surcharge is the noblest ambition of the trustee." He states that a constant, affirmative effort is constantly being made by trust officers, and that they are continually seeking the attainment of a "constructive and legitimate goal" without the relaxation of necessary safeguards. In this connection, he points to the legislative revision in New York State which, in effect, redefined a "legal investment" and permitted the prudent man rule up to 35 per cent of the fund. This is one of the noteworthy achievements of the Trust Division of the New York State Bankers Association.

A bank, Mr. Helm emphasizes, must staff the investment unit with men who are not merely capable, but who are also experts in their field. Such men must be alert, aggressive and analytical, and in a position to appraise man-

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agement. They must do more than look at the historical figures of the past and must be able to visualize future trends.

A proper staff must also be implemented with the best working tools. Required are the recognized statistical services, as well as the credit information available in the banking department. Also essential is the practice of visiting the plant and talking with the management of the companies whose securities are held in trust accounts.

According to Mr. Helm, the compensation received for banking services in the past ten years has not kept pace with rising costs and prices in general. This applies, he states, with equal force to the fees charged for trust services, as well as interest rates. The last increases in statutory fees, obtained in 1946, were not all that was hoped for and did not equal the increased cost of handling accounts. Consequently, preparation is being made to submit a proposal for the future raising of fees to the New York State legislature next year.

Stock Prices

In the past, dividends and stock prices have proved much more vulnerable to a cyclical downturn than business activity. For example, during the last substantial cyclical recession in 1937-1938, the decline in profits, dividends and stock prices exceeded the fall in business activity and was very much greater than the drop in gross national product.

Stock prices will continue to fluctuate with business conditions. But profits, dividends and stock prices are expected to be considerably less vulnerable than business activity during the next recession. This is the opinion of New York University Professor Jules I. Bogen who points to the fact that income taxes now absorb nearly 60 per cent of corporate earnings as against a take of 20 per cent in 1937. When pre-tax profits dropped a dollar in 1937, net income fell about 80 cents; today, a decline of a dollar in pretax earnings would involve a decline of only 40 cents in net income. Thus, the highest corporate tax level in history furnishes a thick cushion in net corporate profits.

Furthermore, it is anticipated that tax rates will be reduced in a recession. When inflation is no longer a threat, it is probable that tax rates will be cut regardless of the position of the budget. In addition, after so long a period of prosperity with high taxes, managements have not been as cost conscious as they will be in a recession. Efforts in this direction should assist in the maintenance of an adequate level of corporate profits.

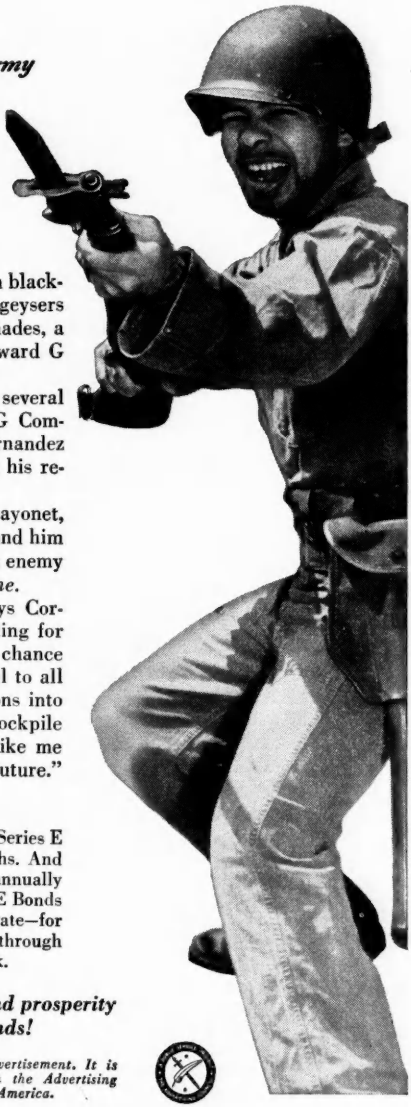
Also to be considered are the following facts. Corporations are paying out not quite 50 per cent of their net income. Reductions in personal income tax rates—and the allowance of any tax credit granted dividend income—will result in more pressure on management for more liberal dividend policies.

In view of the moderate price-earnings ratio, relatively stable earnings and dividends, Professor Bogen believes that stock prices should be relatively more stable than they have been in other recessions.

Corporal

Rodolfo P. Hernandez, U.S. Army

Medal of Honor



0200 HOURS! Suddenly the pre-dawn blackness on Hill 420 split into crashing geysers of flame. Yelling, firing, hurling grenades, a horde of Reds pushed up the hill toward G Company.

A hot fire fight began. It lasted several hours. Finally, out of ammunition, G Company began to withdraw. Corporal Hernandez stayed, throwing grenades and firing his remaining rounds.

Then his M-1 jammed. Fixing his bayonet, he leaped out of his foxhole. They found him in the morning, wounded, ringed with enemy dead. He had stopped the attack—*alone.*

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